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IDE Spot Survey

# ***Hong Kong 1997***

## ***Society in Transition***

November 1996



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**INSTITUTE OF DEVELOPING ECONOMIES**  
**TOKYO**

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# IDE Spot Survey

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## *Hong Kong 1997* *Society in Transition*

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**INSTITUTE OF DEVELOPING ECONOMIES**  
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# Preface

In just a year's time, China will resume its sovereignty of Hong Kong from the hands of the British. There is not only a psychological countdown by the people of Hong Kong, but an actual countdown by a clock installed in the Hong Kong Macao office in Beijing. But, is a countdown now necessary? For some people 1997 is no longer an issue, it has come and gone! This is largely true because Hong Kong had thirteen years of preparation for the event after the Sino-British Joint Declaration signed in 1984. More importantly, China has been playing an increasing role in Hong Kong in the past few years in the run up to 1997. In a sense, most Hong Kong people have realistically accepted Hong Kong's return to China and are well prepared for it.

There are many reasons for us to believe that Hong Kong will have a smooth transition in 1997 and the prosperity of Hong Kong will continue. First, despite the absence of a "through train" in the Legislative Council, the disruption will be minimal. Hong Kong people will soon come to terms with the reality. Things will be alright as long as the executive-led government system is maintained and there is continuity in the operation of government businesses. We should not even be concerned with some changes in the top civil servants as long as the civil service system remains unchanged. The future political system which allows for a gradual process of democratization has been well-defined by the Basic Law and could not therefore be drastically changed. Second, the existing high-handed policy adopted by China over Hong Kong is largely a result of China's objection to Governor Patten's (or Britain's) China policy and style. After the change of sovereignty in 1997, Hong Kong as a Special Administrative Region (SAR) can protect its own interest and negotiate with the Central government in its own right. During the transition period, the interest of Hong Kong is submerged amongst the arguments between China and Britain. Third, there are absolutely no incentives for China to destroy Hong Kong's vibrant economy. First of all, it is a question of face. How could China face the world if the economic success emerged during the British Colonial rule cannot be sustained under Chinese sovereignty! Also, Hong Kong is still of vital importance to the further modernization and development of the Chinese economy. Hong Kong's major contribution in the near and medium future is not so much entrepot services, direct investment, financial services, etc. but more important in providing the mastermind and software in binding up some economic institutions (especially those related to financial development and macroeconomic control) in China. Hong Kong can play a more significant role in this because of our better understanding of the Chinese situation. For a long time to come, the role of Hong Kong in China's development remains irreplaceable.

If there are any risk factors, they are whether the institution in Hong Kong at large will be preserved and whether the superior quality of human resources in Hong Kong could be maintained. The institution at large prefers the ways that things are done in Hong Kong; it can be readily recognized but is difficult to define. It sums up such things as the rule of law, the predictability of policy, the certainty of procedures, the efficiency of operations, etc. While China certainly has no intention whatsoever to destroy Hong Kong, it may inadvertently damage the corporate culture of Hong Kong Inc. With the massive influx of population from China (150 a day legally and possibly another 50-100 a day illegally), we need to have vigorous and well thought out programs of training, retraining and formal education to maintain the quality of our labor force.

Edward K. Y. Chen

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# Chapter I

## Transition from “British Colony” to “Special Administrative Region”

### *Issues in the New Nation Building*

*The Chinese have erected a clock in Beijing's Tiananmen Square counting down the time left until the return of Hong Kong on July 1, 1997. The clock reads “XX Days and XX Seconds Until Return.” The second figure changes with each passing instant impressing upon viewers the inevitability of Hong Kong's return.*

*The return of Hong Kong will probably be the last big event in the history of 20th century East Asia.*

From China's viewpoint, regaining control over Hong Kong will allow it to eliminate the last vestiges of the humiliations from modern history. After all, Hong Kong gained its place on the world stage in the aftermath of the Opium War. This was the beginning of a string of Chinese defeats and the semi-colonization of China by foreign powers. The Hong Kong island has remained as a thorn in China's side ever since it was ceded to Great Britain in the 1842 Treaty of Nanking.

Despite the fact that the return is nominally an “emancipation from imperialists,” the residents of Hong Kong are not very pleased at being reembraced by their “mother country.” The media continues to predict that the exodus of the people will lead to Hong Kong's downfall after return.

What issues are involved in the return of Hong Kong?

### *A Community Different from the Mainland China*

The problem of the return of Hong Kong can be summarized in a few words. While Hong Kong, like mainland China, is primarily comprised of Han Chinese, it represents a different community from the mainland China.

A major change in Hong Kong history occurred at the time of the Second World War.

Before the war, the British crown colony of Hong Kong had maintained close relations with the Chinese mainland. As seen by the participation of Hong Kong workers in the strike of maritime workers in 1922 and the general strike in Guangzhou and Hong Kong in 1925 to 1926, pre-war Hong Kong was closely linked politically with mainland China as well.

The establishment of the People's Republic of China in 1949 and the subsequent Cold War structure wrought changes in the relations between Hong Kong and China. The participation of China in the Korean War through the dispatch of a “Volunteer Army” led to the adoption of a containment policy toward China by the U.S. and other Western nations. The 1951 UN ban on the export of strategic materials to China and the U.S. ban on imports of Chinese products dealt destructive blows to Hong Kong, which had traditionally served as the main port for entrepôt trade with China.

For Hong Kong, the new path to survival lay in industrialization. At the time, Hong Kong received an influx of capitalists from Shanghai fleeing life under the Communist regime. These entrepreneurs tapped the huge number of refugees from the mainland to build textile and other light industries. Accordingly, Hong Kong was the first among the present Asian NIES to succeed in economic development through an export orientation.

Along with the progress in industrialization, Hong Kong made strides in integrating various groups of new immigrants. Faced with a huge refugee population, the government began constructing large blocks of public housing in 1954. The mix of Cantonese, Teochews, Shanghainese, and Hakka in this housing gradually led to the use of Cantonese as the lingua franca. Classes conducted in English became the educational norm.

The postwar baby boom also resulted in a large post-war generation of people born in the territory. The second generation of immigrants had no experience with life on the mainland China. For them, unlike their parents, Hong Kong was not a

temporary shelter where they could accumulate wealth before returning home, but a true home in its own right.

### ***Establishment of the Hong Kong System***

Building on the integration of various new groups within the immigrant populations, postwar Hong Kong established its own system – one sharply different from mainland China.

First, mention may be made of the “laissez-faire” policy adopted in the economic system. The Hong Kong government stresses the market mechanism and limits its own role to the provision of public property and avoidance of market collapse.

Public disclosure of information and thorough adherence to the principles of competition are necessary for the adoption of a laissez faire policy. Hong Kong meets these criteria. Hong Kong has a highly independent media and the government adopts a competitive tender system. There is a tendency towards a light view of welfare under the rule of this “small government.”

The political system, including the social system in its broader sense, has the following features:

The political system in Hong Kong has traditionally been a non-democratic one with power concentrated in the hands of the colonial governor. The governor was appointed by the Queen of the United Kingdom (U.K.) and never had to undergo a baptism of public opinion through elections. He was the only real power in the territory's legislative and executive branches.

Judicial independence, however, has long been maintained in Hong Kong. Hong Kong adopts the Common Law, the Equity, as well as its own customary law. When dissatisfied with decisions in the territory, it is possible to lodge an appeal at the Judicial Committee of the Privy Council in London. This legal tie with the U.K. creates a judicial environment conducive to foreign capital in Hong Kong.

Hong Kong enjoys the highest level of freedom of press in all of Asia, with various English language media using Hong Kong as a base for reporting in Asia.

In addition, a series of government reforms in the 1970s enabled Hong Kong's civil service to exhibit a high level of administrative efficiency.

While Hong Kong has not had elections for most of its history, a network of advisory committees spanned the government and served to absorb and reflect public opinion.

As a result, despite the fact that it has traditionally operated under a non-democratic political system, Hong Kong has exhibited strong political stability.

### ***Contradictions in the Method of Integration***

Hong Kong's return to the mainland arose as a practical issue when the Cultural Revolution ended and the open-door policy was launched on the mainland. The issue of return was in fact raised by Hong Kong itself. With the expiration of the lease on the New Territories (99-year lease of the New Territories by England from Qing Dynasty in 1898) fast approaching, it became necessary to plan for the future of Hong Kong after 1997 in order to maintain its economic prosperity.

While the U.K. wanted to continue its administration over Hong Kong, China expressed its intention to reclaim sovereignty. Hong Kong relies on the mainland for its food and water. Therefore, independence from the mainland was never a realistic option for Hong Kong.

This being said, after successfully integrating various new groups within the immigrant population and establishing a “Hong Kong System,” the territory found itself too socially distant from the mainland. Rapid reintegration would harm the vitality of Hong Kong and would also run counter to China's desire to use the territory to contribute to its own modernization.

As a result, the “one country, two system” approach has been adopted as the method of reintegrating Hong Kong with China. This framework is that two systems, the Chinese system and the Hong Kong system, might function harmoniously in one country, the People's Republic of China. China will regain sovereignty over Hong Kong on July 1, 1997, but it is assumed that Hong Kong will enjoy a high degree of autonomy, except in foreign relations and defense, as a Special Administrative Region (SAR), for the following 50 years.

This “one country, two system” approach, however, contains some fundamental contradictions. When the Hong Kong Special Administrative Re-



gion government differs on an issue with the Chinese central government, which choice will priority be given to? Namely, will the "one country" or the "two systems" be stressed?

While Hong Kong is calling for respect on the "two systems," China has leaned heavily toward "one country." China includes within its borders the vast minority regions of Xinjiang, Tibet and Inner Mongolia, and therefore deems stability and unity to be of prime importance. There is concern that the very existence of Hong Kong will stir calls from these minority regions for upgrades to "special administrative regions" as well.

### ***Political Backlash***

In the transitional period until return, friction over the "one country, two system" approach has already become visible between Hong Kong and China. The main issue is the political reforms in Hong Kong. In the transitional period, the differences in the two political systems have become relatively greater.

The open-door policy beginning in the late 1970s has reduced the differences between Hong Kong and China in their economic systems. China aggressively worked to attract foreign investment, adopted the market mechanism, and established ability- and performance-based wage systems. Rapid changes have been made in dismantling China's socialist planned economy and its underlying principle of state ownership.

Progress has been made in the economic integration of Hong Kong and China during this period. When the Pearl River Delta region adjoining Hong Kong was opened to investment in 1985, Hong Kong manufacturers began successively moving their factories there. Access to the Delta relieved greatly the problems of labor shortages and cramped space endured by Hong Kong manufacturers up to this point. China has also made positive use of Hong Kong as an international financial center. Being the largest investor in Hong Kong, Chinese state-owned enterprises were first listed directly on the Hong Kong stock market in 1993. In 1994, the Bank of China even began issuing Hong Kong dollar notes.

On the other hand, the political reforms in Hong Kong, the bone of contention between Hong Kong and China in the transitional period, were

begun by the Hong Kong government. This is linked with the U.K.'s desire for an "honorable withdrawal."

The U.K. and Portugal have adopted different approaches to their colonial charges. The U.K. amended its Nationality Act in 1981 to legally restrict entry of Hong Kong residents. Portugal, on the other hand, stands in sharp contrast by guaranteeing the right of persons born in Macau to abide in Portugal.

The decision to return all the territory of Hong Kong, including both the ceded and leased territories, was seen by many in Hong Kong as the U.K. selling Hong Kong out. It was necessary for the U.K. to eliminate the apprehensions of Hong Kong residents over life under Chinese control so as to ensure smooth return. Political reform in Hong Kong was undertaken within this context. Young Hong Kong intellectuals supported the reforms as establishing a "bulwark" protecting the Hong Kong system.

As a result, a tide of democratization began to sweep Hong Kong beginning in the 1980s. The government-led reform of the political system mainly took the form of the introduction of an electoral system. In 1982, direct elections were held for the District Boards responsible for local administration. Democratic forces in Hong Kong called for the introduction of direct elections to the Legislative Council in the territory in 1988.

This series of events prompted China to caution restraint, stating that rapid changes could invite political instability and threaten the prosperity and stability of Hong Kong. The Tiananmen Square crackdown of 1989, however, increased the fear of Hong Kong residents over their future after return and further spurred the democratization of the territory.

The support for democratization in Hong Kong might be seen in the landslide victory of the democrats in the 1991 direct elections for the Legislative Council. Governor Patten, who took office in 1992, proposed further reform of the political system aimed at maximum democratization in the framework of the Basic Law, a mini-constitution for Hong Kong after return.

Patten's proposal again fueled tension in relations between the U.K. and China and relations between China and Hong Kong. China criticized Patten's proposal as violating the Sino-British Joint Declaration, Basic Law and related agreements. Pat-

ten's Proposal, however, passed the Legislative Council in 1994, and as a result, new elections were held in 1994 and 1995. China subsequently adopted a tough stance of ignoring these political developments in Hong Kong. It has repeatedly said that it will dissolve the tertiary councils elected under the new electoral system after Hong Kong's return. To avoid a power vacuum after the dissolution of the Legislative Council, China plans to launch a provisional legislature – something not provided for in the Basic Law.

### New Issues in the Nation Building

Will Hong Kong's return proceed smoothly then? The answer is yes. Of course, all three parties, China, the U.K. and Hong Kong, want return to proceed without harming the territory's "prosperity and stability." Since Hong Kong and China remain so different in terms of their societies, however, it would be too simplistic to expect return to proceed with no friction.

The friction between Hong Kong and China in the transitional period is simply a prelude of things to come. The difficulty of reintegrating Hong Kong into China will instead become more severe after the return. This is not because China is likely to force a "one country" approach and risk sapping the vitality of Hong

Kong. The difficulties in reintegration may well be more of a burden to the leaders of the Chinese central government than to the people of Hong Kong.

The reason is that the market is assessing the value of Hong Kong's future moment by moment. Although the exchange rate of the Hong Kong dollar is stable because of being pegged to the U.S. dollar, the Hang Seng Index is not subject to government control. Its wild upswings and downswings will starkly reveal to the outside world any turmoil inside Hong Kong. In addition, China's

open-door policy has led to diverse new political demands inside the society. After losing the charismatic presence of Deng Xiaoping, China will have its hands full governing itself, much less the return of Hong Kong.

In whichever case, with the 21st Century fast approaching, China will have to integrate a new population, that of Hong Kong, into its society. What happens to Hong Kong after its return will be watched with great interest by Taiwan – another potential candidate for reintegration into the mainland. The results of the elections held in Hong Kong since the 1980s demonstrate Hong Kong residents' support for democratization. The recovery of this "lost territory" may place a heavy burden on the running of the Chi-

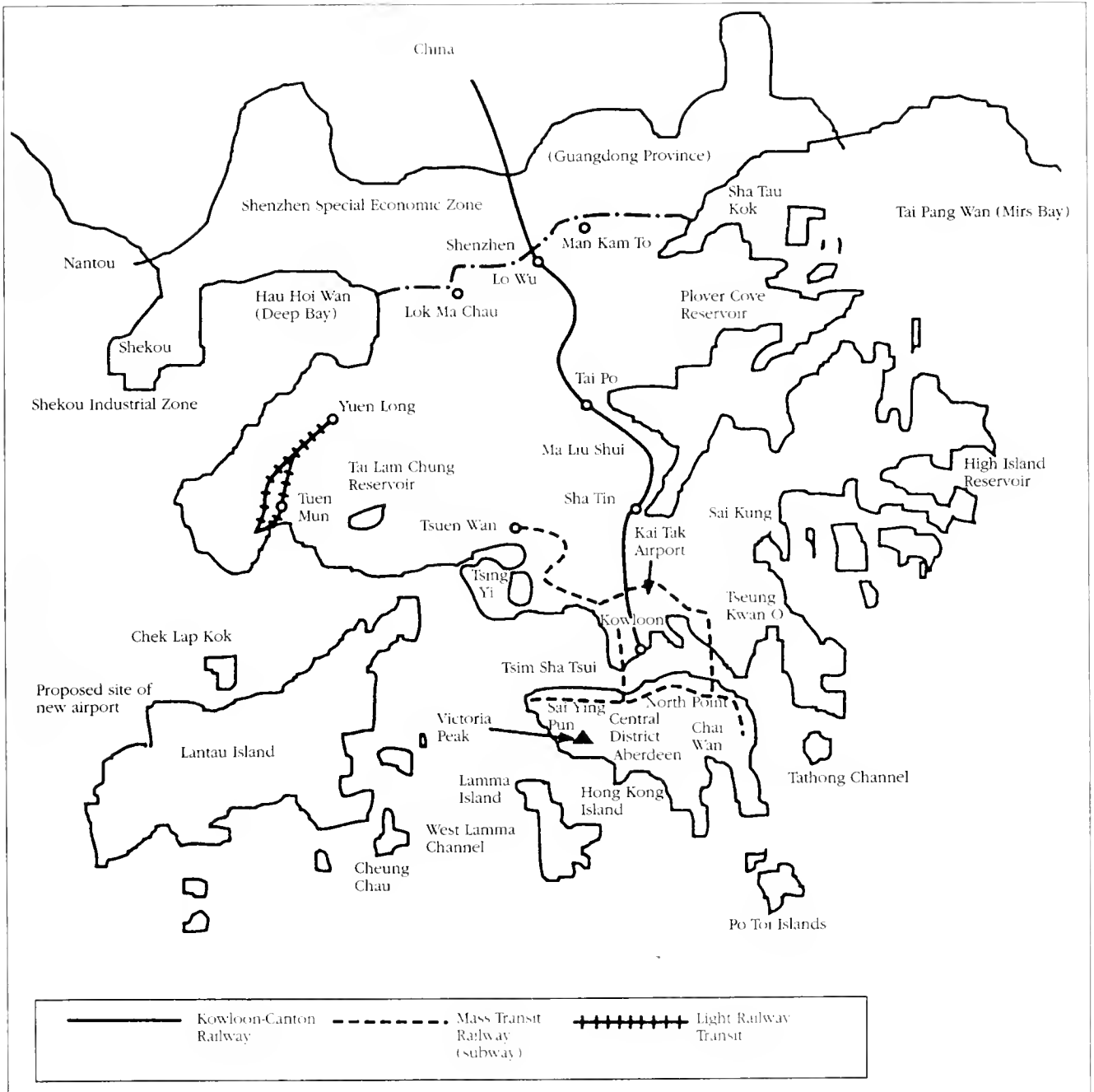
nese state with the reintegration of a new "stranger."

模擬特區首長選舉 投票結果	
總票數	765 票
① 梁振英	78 票
② 吳光正	28 票
③ 陳方安生	413 票
④ 楊鐵標	41 票
⑤ 董建華	54 票
⑥ 李柱銘	118 票
⑦ 許國賢	13 票
⑧ 其他	7 票
— 棄權	8 票
— 廢票	5 票

香港大學社會科學院學生會  
多謝大家支持!

A moot election for SAR Executive Chief

## Hong Kong Overview



Source: Institute of Developing Economics, *Asia Dōko Nempo 1996* (Asia Trends Yearly, 1996)

# Chapter II

## Relationships between Hong Kong and China in the Post-1997 Era

1. There are great uncertainties about the future economic relationships between Hong Kong and China after 1997 when China will resume sovereignty over the territory. It is true that the Basic Law, which is based on the Sino-British Joint Declaration rectified by the National People's Congress in Beijing, will provide the basic framework for the governance and basic orientations for economic, social and political policies of the post-1997 Special Administrative Region government. At the level of actual policy formulation and implementation, there are, however, many areas not being covered by specific rules and guidelines promulgated in the Basic Laws, and which need the SAR government to negotiate with the central government for clarification.

2. The most important issue is how the SAR government is going to deal with the various organizations of the central government and local governments. Prior to July 1, 1997, the Hong Kong and Macau Office (hereafter as HKMO) of the State Council has served as the governmental link between Hong Kong and China. Together with the Hong Kong Office of the New China News Agency, both are part of the set-up of the Hong Kong and Macau Committee of the Chinese Communist Party, the highest policy-making and implementation body of the party-government-military complex of China, have been entrusted with the power to screen, approve and monitor any exchanges between Hong Kong and China's government apparatuses, and coordinate the activities of the state-owned and government-controlled entities set up in Hong Kong by the various levels and departments of the Chinese government apparatus. So far they have done a good job, but as China has begun to quarrel with the British government over the transitional arrangement, their functions and role have gradually shifted to behaving more like the official representative of the central government: to negotiate, and to 'fight' against the unacceptable policy 'deviations' of the British government in Hong Kong. They are no longer the service department they were originally intended for, and with the task

of representing the central government, they have begun to take over the preparation of actual governance of Hong Kong in the post-1997 era, interpreting freely the Basic Law and making decisions over the actual institutional and political preparations directly or indirectly through the Preliminary Committee and the Preparatory Committee, members of which were selected upon their recommendations. The proposal for a provisional legislature not provided in the Basic Law is the most outrageous act of these two 'service' organizations.

The Basic Law is definite about the selection and appointment procedures for the executive government and the legislature of the SAR government. But with the provisional legislature and the manipulation over the selection of the Chief executive and his/her senior officers at the secretary level before and in the immediate one or two years after 1997, even though the Hong Kong Office of the New China News Agency would be reduced to a small team of central representatives in Hong Kong, HKMO might still exercise enormous political influence over the government and policies in the territory after 1997. If the practice of the pre-1997 era continues after 1997, governmental contacts and cooperation between Hong Kong and China have to go through the coordination and screening of HKMO, the SAR government might become in effect a colonial establishment of China in Hong Kong, working only under the guidance and supervision of HKMO, whose Director has the same ministerial ranking as the Chief Executive of the SAR government but is responsible directly to the Premier of the State Council, and which has 'policy' departments at the bureau (Chinese) or secretary (Hong Kong) level matching the future set-up of the top policy-making structure of SAR government. Even if the central leadership of China will not intend HKMO to behave like a king-maker for the SAR government, the simple organizational imperative of HKMO, tempted by the enormous power and potential interests that might come from it, would push the officials of the office to strive for such a role. The SAR government would face a

formidable task to break through the monopolistic control exercised by HKMO over Hong Kong's link, transactions and negotiations with other organizations of the central government and the numerous local governments in China. Without direct access to the different levels of the party-government-military complex of China, Hong Kong would be very much handicapped in developing means and knowledge in dealing with the expected intensified dealings with the Chinese government. And with the enormous power, albeit informal not formal, in the hands of the HKMO, vested interests in Hong Kong would struggle to build special connections with the officials there. As HKMO is not directly monitored by the National People's Congress and its policy and work have been rather secretive, even the Chinese government and legislature would have problems in watching over it. The possible collusion between some officials of the office and some vested interests in Hong Kong pose perhaps the biggest threat to the fair and open rule of politics in the territory after 1997, damaging the local rule of law and development of democracy.

3. Another major consequence that might come from the *de facto* supervisory function and role of HKMO over the formation and operation of the SAR government would be the impossibility of defending local interests against encroachment from the different government organizations and large state-owned firms from China. Already in the early 1990s, the growing economic exchanges between Hong Kong and China has led to a proliferation of transport links between the two places. As Hong Kong has no political representative in Beijing, Hong Kong has always lost out in negotiation for reciprocity in the granting of cross-border aviation, shipping and road transport rights. As a result, there are more Chinese firms backed by different levels of Chinese governments that have the right in operating cross-border traffic than Hong Kong firms. The HKMO has on no occasion spoken in defense of the interests of territory. Instead it appears to defend more the Chinese interests, and often with the political excuse that the Hong Kong government is still British and colonial before 1997, regardless of terms of transportation rights that extend beyond 1997. In a more recent case, despite the fact that the demand of the Chinese national aviation company for representing the local flag in national and international air traffic has posed a

serious threat of encroachment by mainland interests, the HKMO has made no attempt to dissuade the Chinese aviation company or to appeal to the State Council for intervention. The eventual purchase of the local airline, Dragon Air, has put more pressure on the other locally based international airline, Cathay Pacific, whose operation relies very much on reciprocal rights granted to the Hong Kong local flag carrier by other governments. And the reluctance of the Chinese government, and HKMO in particular, in recognizing Cathay Pacific as the local flag-carrying airline has caused the airline serious troubles in defending their services to a few countries under the reciprocal treaties between Hong Kong and foreign governments. The hostile attitude of the HKMO against British interests in Hong Kong and its reluctance or inaction to defend local interests by referring to the Basic Law and the principle of one country two systems against the encroachment of Chinese state-owned firms, would only encourage more numerous and more aggressive hostile takeovers. Hong Kong Telecom is now subject to hostile purchase by major Chinese firms. There should be more to come in the next few years, probably with the political excuse of replacing the powerful old British Hong Kong by those from the mainland. This would definitely alter the rules of game in the corporate sector in the territory, to the detriment of the fair and competitive market system that has been the foundation of the metropolitan nature of Hong Kong.

4. If the HKMO is not able to exercise *de facto* supervisory control over Hong Kong after the election of the first legislature according to the Basic Law, there would still be problems for the SAR government. Because of the non-democratic rules it sets for the Selection Committee for the chief executive and part of the first legislature and the strong reaction of the local population towards the provisional legislature established mainly by appointment for the first year after July 1, 1997, the doings or wrong doings of the HKMO in the last one or two years leading up to 1997 and beyond would simply be laying the ground for a political and social schism in the post-1997 Hong Kong. The subsequent elections would be bitter and the more popularly elected legislators would come into conflict with the much less representative chief executive, and the legitimacy of the SAR government in the eyes of the local population would also be

damaged by both the undemocratic elections of the Selection Committee, the chief executive and the provisional legislature and the subsequent hostility and conflicts between the legislature and the chief executive. The post-1997 legislature and executive government may blame the HKMO for all these problems. However, the post-1997 political mechanism would not provide any effective means for resolving the serious political dissensus, unless there were democratic modifications to the established methods of selecting the chief executive and when according to the Basic Law there would be fully popular election of the legislature in the future. If the HKMO maintains its supervision over the SAR government, it would definitely intervene, but it would have little choice left for the method of intervention. Either, following the politicizing approach it has adopted before 1997, it would label all those popular forces as anti-China and conspiring with the British and American, and recommend drastically repressive measures, which might or might not be accepted by the central government then, depending very much on the international political environment prevailing at that time. Or it would try to mobilize all the economic, social and political forces in Hong Kong under its control or influence to support the chief executive it has helped to choose, thereby intensifying further the social and political schism and spilling it over to the economic arena. The possible damage on Hong Kong would be enormous.

5. There would be another destabilizing factor in the political scenario presented above. By 1996, it has become obvious that the rapid structural transformation of the local economy from a manufacturing one to one dominated by services in the last 10 years has created a very serious problem for the society. Structural unemployment, which was not helped by the prosperity in the real estate and financial sectors but exacerbated by the technological changes in the latter sector, and the general recession of domestic real sectors, manufacturing and services that depend on domestic demand would not only drag the rate of economic growth of the territory down to 3.2% GDP growth in the last quarter of 1995, but would also widen income inequality, suppress average real wages and frighten off foreign investment trigger capital flight. Since labor is immobile, in sharp contrast to capital, unless the government would be willing to find

ways to reduce the cost of living burden on the general populace, rising unemployment and wage decline even at a level lower than in most other countries would still cause serious strain and tension in the society. Coupled with the political hostility and conflict generated from the post-1997 political system, there should be ground for at least a limited scale of social disturbance. Social tension would feed political hostility, and in response, either invite intervention from the Chinese government or paralyze the SAR government by political dissensus and open confrontation in the society. The prospect for social, political and economic stability might be slim at least in the first few years of the SAR government.

6. However, the political prospect of the SAR government might not be so bad. The determination of the central government to maintain economic prosperity and political stability is beyond doubt. And the economic growth of China seems to be guaranteed by the cautious, gradualist economic reform and conservative macroeconomic policies. Guangdong may have been suffering from a relative decline in its economic dynamism and importance in the national system, past investment should still be strong enough to sustain a modest economic growth there to help boost growth in Hong Kong. In particular if the central government wishes, relaxation of cross-border trade and personnel traffic between Guangdong and Hong Kong would provide a new stimulus to the expansion of production, trade and services controlled by or located in Hong Kong. More significantly, the central government also has other resources that may be utilized to push up demand and growth in the Hong Kong economy. For instance, it could allow more Chinese tourists to come to Hong Kong, further accelerating the current trend, and approve more large state-owned corporations to come to use Hong Kong for the local financial services and as bridgehead from which they could launch into the outside world as multi-national corporations. On the other hand, the enormous political influence of the central government over the SAR government, especially through the undemocratic mechanism the HKMO has helped to install, could be deployed to constrain the chief executive and the pro-China political and business interests, forcing them to adopt a more cooperative, conciliatory and open attitude towards its political opposition. To improve the domestic demand for growth, an easy way would be to use the stored up billion-dollar reserve of

the government and the quasi-government Housing Authority to build more low-cost public housing for the lower income groups and through this indirect means suppress the excessively high housing and rental prices and in turn reduce overall living and production costs. It may be difficult to restore overnight the competitiveness of the Hong Kong economy through structural upgrading. But it should not be difficult to reduce the overall cost level by suppressing property prices, as in recent years property price has constituted the major cause for cost inflation in the territory. In addition to building more public housing, reversing the deliberate pro-real estate developers policy of the British government in Hong Kong in the last 10 years, the SAR government would easily get the support of the central government to extend the provision of cheap public housing for the local population to Shenzhen, the Special Economic Zone of China north of the territory.

7. The crucial key is: has the central government realized the severity of the threat of political mismanagement and economic recession to the continuous economic prosperity and political stability of Hong Kong in the post-1997 era? Despite the hard-line and excessively politicized position of the HKMO, there have been indications that the central government or the top leaders have always come in at times of crisis of political confidence in Hong Kong to seek compromises. Since early 1995 the central government has also become alarmed by the deteriorating economic performance in the territory and efforts have been made outside the HKMO to study and find ways to sustain the growth of the Hong Kong economy. For instance, the powerful State Planning Commission of the State Council has already started research into economic problems of Hong Kong. When the slow-down and recession of the domestic sectors become more definite in the later months of 1996 and towards 1997, dispelling all the myths of perpetual economic prosperity on the basis of a steadily rising real estate market, the central government would surely put more pressure on the HKMO and seek ways other than the present overtly politicized ones to restore local confidence and cooperation, so that on a wider popular basis measures would be undertaken to reverse the current deteriorating eco-

nomie trends. One could not count on the faith of the central government of China in the capitalist system of Hong Kong, nor their commitment and responsibility towards the local population, but instead the enormous liabilities and political risk to China and the central leaders themselves of an economically declining and political unstable Hong Kong after 1997. To avoid this and to prove itself to the world, including the hostile British and American political forces, and to the people of China, who envy the wealth of the Hong Kong people and the special policies granted to Hong Kong for 50 years, and to the government and people of Taiwan, which China hopes to reunite in the not too long future, the central government has to make post-1997 Hong Kong a showcase. And to do so the central government has the successful example of its economic reform for reference: by means of a cautious, gradual and trial-and-error approach with stability as the overriding priority and condition. This may not mean democracy of the western style, but a high degree of popular participation through formal and informal channels and a high sense of government responsibility. The gradualist and cautious approach of the Basic Law will be and should be the most appropriate framework for such a choice.

8. There will be threats and crises in the transition of Hong Kong into the post-1997 era. Uncertainties and doubts have been caused mostly by the political mismanagement of the Chinese government through the work of the HKMO. But with the determination of the central government to keep Hong Kong a showcase after 1997, there should be a good chance for the central government to learn to manage Hong Kong properly in an indirect fashion and through a more popular and cooperative SAR government.



**A demonstration march on the Diaoyu tai Island issue  
(Sept. 15, 1996)**

# Chapter III

## The Hong Kong Economy on the Eve of Return

### *Introduction*

It is now less than a year until July 1, 1997 for the return of Hong Kong to mainland China. There have consequently been a spate of discussions as to whether the enclave will be able to maintain its current level of prosperity after the transition of sovereignty. The debate over the future of post-return Hong Kong focuses on the problems accompanying the transition from a British to Chinese system. A more measured look at recent trends in the Hong Kong economy, however, show that be-

cast shadows over the ability of Hong Kong to function as a base for doing business with the PRC.

Accordingly, when examining the future of Hong Kong following its return, although one's attention inevitably tends to be drawn to the change in systems, the problems facing the Hong Kong economy in the transitional period will stem rather from inside the enclave itself. This article will therefore first clarify the state of the Hong Kong economy a year before transition of sovereignty and the state of the close economic relations between China and Hong Kong. Next, it will show how

the ability of Hong Kong to act as a base for doing business with China, a role which has sustained its economic development in the past, is beginning to ebb. Finally, it will discuss the problems which will have to be overcome to enable prosperity in Hong Kong following its return and measures to deal with them.

### *Downturn in the Hong Kong Economy*

The political standoff between China and the U.K. which arose after Governor Patten's proposals for political reform only worsened with Hong Kong's election of the Legislative Council in September 1995, China's announcement of the members of the Preparatory Committee of the Hong Kong Special Administrative Region at the end of 1995 and the establishment of the Provisional Legislative Council. As a result, with each passing day as Hong Kong nears its return, uncertainties are mounting over the political future of the enclave. As if in response to this, the U.S. business journal "Fortune" downgraded Hong Kong from first (1994) to sixth place in its 1995 ranking of business cities around the world. The reason being that even if its role as a window for business with China remains unchanged, there are growing political uncertainties as 1997 approaches.



**Central district:  
A business center of Hong Kong and Asian economies**

fore any concern emerged over governability accompanying the transition of systems, the main factors which have sustained the Hong Kong economy to date have already been shaken by changes in the economic environment inside and outside the enclave. Specifically, while Hong Kong grew in its position as the gateway to China or through integration with the Chinese economy after Beijing launched its reforms and opened its doors to the outside world, the recent economic growth of the mainland, the rethinking of its foreign investment policies and the growth of the Hong Kong economy to the level of a developed country have



"Fortune" is not alone. For a while, the prevalent opinion even in Hong Kong was that the murky political outlook was having a detrimental effect on the economy. Hong Kong had maintained a high level of economic growth beginning in 1991 due to the accelerated pace of reforms in China, but in 1995 saw its real growth rate drop to 4.3 percent — falling below the 5 percent line for the first time in five years. In particular, there was a clear drop seen from the second half of 1995. Growth fell to 4.2 percent in the third quarter of 1995, to 3.2 percent in the fourth quarter, and to 3.1 percent in the first quarter of 1996.

In so far as the macroeconomic indicators of Table 1 are considered, the direct reason for the slump in business was the sharp nosedive in private consumption expenditure. Until that point, private consumption had outpaced the GDP in growth, but in 1995 it suddenly dropped back to 1.3 percent. This was the lowest rate of growth in 20 years since 1974 when minus 2.1 percent growth was recorded. In particular, auto sales plummeted a substantial 30 percent from the previous year, while sales of durable consumer goods dropped across the board as well. Empty tables have also become visible recently at fancy restaurants — which had been packed and had turned away guests without confirmed reservations as recently as two years ago. The rumor is spreading that the Hong Kong people are cutting down on spending and building nest eggs in preparation for return.

A more studied analysis of Hong Kong macroeconomic statistics, however, reveals that the politi-

cal uncertainties are not really having a detrimental impact on the Hong Kong economy. The nominal rate of growth of private consumption expenditure surpassed the GDP growth rate even in 1995, and the ratio of private consumption expenditure to the nominal GDP, in fact, increased. If people were building up their bank accounts due to their concerns over the future of the enclave, the rate of growth of consumption expenditure should at least have been less than the nominal rate of increase of income revenue. Accordingly, the cause for the slump in private consumption expenditure must be sought in purely economic factors.

The primary cause of the first slump in consumption in 20 years was the 1995 plunge in real estate and stock prices, which had risen steadily since 1991, that is, the reverse asset effect. Figure 1 compares private consumption expenditure and asset prices, illustrating housing prices and the Hang Seng Index, and expresses trends over time. The figure shows that stock prices began falling in the fourth quarter of 1994 and that housing prices began dropping in 1995 and thereby sparking the decline in private consumption expenditure. Record highs in real estate and stock prices were behind the high level of growth sustained by the Hong Kong economy beginning in late 1991, the year when Beijing accelerated the pace of its reforms. At the end of 1994, however, stock and real estate prices both tumbled and caused the "economic bubble" to burst, thereby inviting the slump in private consumption expenditure.<sup>1</sup>

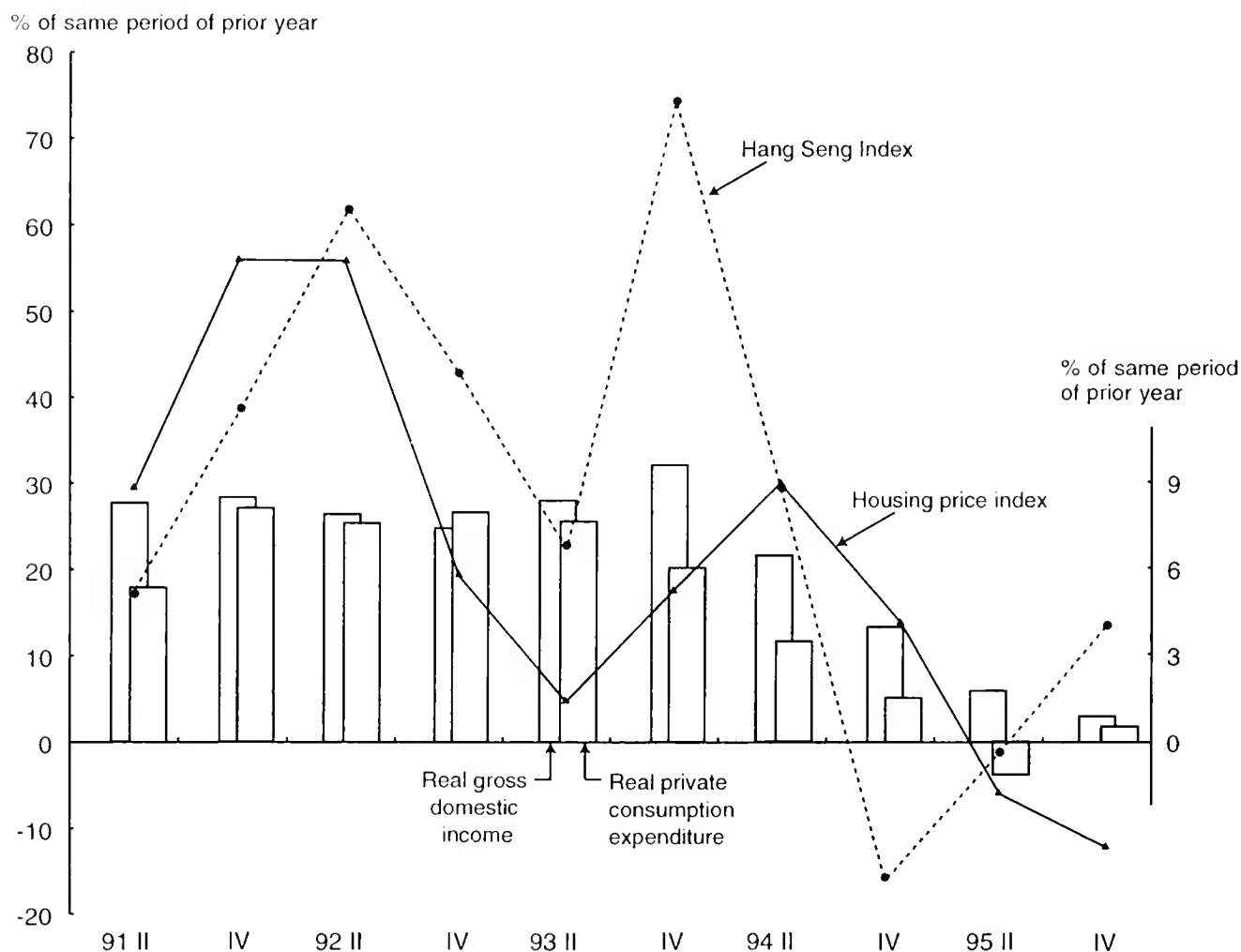
**Table 1. Trends in Hong Kong Macroeconomic Indicators: 1990 to 1995**

	1990	1991	1992	1993	1994	1995
Private consumption expenditure	5.7	8.6	8.5	7.5	6.3	1.3
Public consumption expenditure	5.5	7.7	7.2	2.2	3.5	4.3
Investment	8.1	9.3	9.2	3.7	14.0	6.1
Exports	9.6	17.3	19.8	13.5	10.4	11.9
Imports	11.4	19.0	22.2	12.7	11.0	13.7
Gross domestic product (GDP)	3.4	5.1	6.3	6.1	5.4	4.6
Gross domestic income (GDI)	3.8	6.4	7.8	7.5	3.6	0.5

Note: For method of calculation of gross domestic income, see notes of Fig. 1.

Source: Census and Statistics Department, "Estimates of Gross Domestic Product 1961-1995," March 1996, Hong Kong.

**Fig. 1. Fluctuating Correlation between Real Private Consumption Expenditure, and Asset Prices and Real Gross Domestic Income**



Note: Real gross domestic income calculated as follows

$$RGDI = GDP + \left( \frac{X_g}{P_{gm}} - \frac{X_g}{P_{gx}} \right) + \left( \frac{X_s}{P_{sm}} - \frac{X_s}{P_{sx}} \right)$$

RGDI Real gross domestic income

GDP Real gross domestic product

$X_g$  Exports of goods

$X_s$  Exports of services

$P_{gm}$  Price deflator for import goods

$P_{gx}$  Price deflator for export goods

$P_{sm}$  Price deflator for imported services

$P_{sx}$  Price deflator for exported services

Sources: 1. Census and Statistics Department, "Estimates of Gross Domestic Product 1961-1995," March 1996, Hong Kong.  
2. Census and Statistics Department, "Hong Kong Monthly Digest of Statistics," April 1996, Hong Kong.

The fall in real income was another cause. Consumption is income minus savings, so any fluctuation in income naturally has a decisive impact on consumption expenditure. Further, the current business recession is being accompanied by increased unemployment – a rare phenomenon in the enclave. The unemployment rate reached the 3 percent level in 1995 and had climbed to 3.5 percent by the end of 1995. Hong Kong relies on imports for the majority of its durable consumer goods, and forbearance in purchasing manufactured goods therefore should not lead directly to increased unemployment. Accordingly, the simultaneous slump in consumption and rise in the jobless rate can only be explained by the sluggish growth in real income.

Until now, the only macroeconomic indicator available in Hong Kong corresponding to income has been the GDP. In a free economy with as large a scale of overseas transactions as Hong Kong, the GNP, which includes overseas net element income, is best suited as an income indicator. In addition, the real income effect caused by changes in trade terms, namely, the ratio of the export price index to the import price index, is also significant.<sup>2</sup> Statistics on the GNP, however, are difficult to obtain. Hong Kong champions a free economic system, and has therefore been slow to compile statistics on capital transactions. Figures for the nominal GNP for 1993 were only announced at the end of 1995. Statistics on the GNP are essential for an accurate analysis of the Hong Kong economy, but are not available. The authorities recognize the need for information on the real income effect caused by the changes in terms of trade and conducted test calculations in the “Estimates of Gross Domestic Product 1961 to 1995” published in March 1996.<sup>3</sup> Table 1 and Fig. 1 calculate real gross domestic income (after adjustment) as affected by fluctuations in income accompanying changes in terms of trade for not only goods, but services as well. The growth rate over the previous year (same period) for each quarter is shown.

A look at the adjusted real gross income reveals that real gross income growth surpassed that of the GDP from 1991 to 1993, when China was aggressively pressing forward with its reforms, but slowed in 1994 and dropped to zero growth in 1995. Real gross income is a leading indicator of private consumption expenditure as well and has a large impact on trends in private consumption expenditure (see Fig. 1).

A look at recent trends in the Hong Kong economy reveals that while political uncertainties cannot be said to have been absolutely inconsequential, the boom in business with China calmed considerably in 1993, and it was the repercussions of this that surfaced all at once in 1995. Why then did the bubble burst, terms of trade deteriorate and real income plunge? Behind this were, first, the effects of the protracted economic austerity program adopted by China in late 1993 and, second, the destabilization of the role of Hong Kong as a base for business with China due to the speed in which China is catching up, rising costs in Hong Kong and intensifying competition with neighboring countries.

### *Close Economic Relations between China and Hong Kong*

It is necessary to explain the economic integration of Hong Kong and China when considering the impact of China on the Hong Kong economy. Hong Kong has been pursuing economic integration with the mainland since the start of reform and open door policy and has enjoyed striking economic growth as Beijing accelerated its reforms.

When China decided to reform its economy and open up to the outside world, Hong Kong was the first to start up trade with China on a large scale. Trade between Hong Kong and China boomed after a 30-year dormancy both in terms of direct trade between the two partners and the more traditional Hong Kong entrepot trade. Foreign goods were being re-exported to China through Hong Kong, and Chinese goods were being re-exported to the world through Hong Kong. At the same time as it changed its policy toward foreign investment, China embarked on trade more aggressively. Further, its port facilities were terribly inadequate due to 30 years of economic isolationism. This resulted in a sharp surge in entrepot trade through Hong Kong.

Another factor in addition to entrepot trade was behind the jump in trade figures. The manufacturers which had sustained the Hong Kong economy up until the late 1970s increased their consignment processing production in Guangdong and elsewhere after China launched its reforms and open door policy. This led to steadily climbing trade with the mainland as well. The active consignment

processing trade, in which Hong Kong manufacturers exported materials and parts required for consignment processing production to branch factories in neighboring Guangdong, brought the finished products back to Hong Kong and then re-exported them, had a large impact as well.

China's share in Hong Kong's trade rose sharply, and the overall value of Hong Kong's trade, primarily re-exports, also shot up. Hong Kong trade statistics are divided into domestic exports (added value of 25% or more), re-exports and imports. In 1995, domestic exports had risen to 5.7 times the level in 1978, before the reforms and open door policy, re-exports 84.3 times and imports 23.6 times. China's share in Hong Kong's trade, further, grew to 28 percent for local exports, 92 percent for re-exports and 36 percent for imports.

Trade relations between Hong Kong and China did not end there. Hong Kong established itself as a base for doing business with China. Active triangular trade continued to link China with third countries without going through Hong Kong customs. That is, deals were concluded between Chinese export and import companies based on Hong Kong and Japanese and Western trading companies, while the actual cargo was exported directly from Chinese ports to Japan and the West or vice versa. A survey by the Hong Kong Trade Development Council estimated that this triangular trade alone reached HK\$192.0 billion in 1991. This corresponded to 82 percent of domestic exports.<sup>4</sup>

Trade relations between Hong Kong and China are diverse in nature with these trade relations and the function of Hong Kong in entrepot trade being extremely complicated. This is illustrated in a more readily understandable fashion in Fig. 2. The flow of trade is shown by the arrows. The darkened portion in the center represents the Hong Kong region. Trade, other than domestic exports and retained imports, passing through this region constitutes re-exports. Triangular trade not passing through Hong Kong customs is illustrated by the dotted lines at the right of the figure. Before China's reforms and open door policy, trade with China had been of little importance. The situation is tremendously different today with Hong Kong forging close relations with China in trade, as can be understood from the figure. Further, as mentioned earlier, consignment processing trade accounts for a large share of the trade between Hong Kong and China. Entrepot trade is primarily governed by domestic

trends in China, while Hong Kong companies hold the initiative in consignment processing trade. Consignment processing trade is important in the close trade relations between Hong Kong and China in that it functions to protect the economic independence of Hong Kong.

Economic relations between Hong Kong and China in terms of investment have also picked up in recent years. Most of the investments made by Hong Kong in China in the 1980s were small-scale and aimed at consignment processing production, but with the accelerated pace of reforms in China in 1992, Hong Kong began investing in China in earnest, and investment from China to Hong Kong surged as well. In particular, Chinese enterprises made stunning investments in Hong Kong from 1992 to 1994. If operation ended today, it would be a blow to the Hong Kong economy. Direct investment by China in Hong Kong reportedly surpassed the US\$20 billion mark at the end of 1992. Chairman Shen Jueren of the Association of Chinese Enterprises in Hong Kong stated in March 1996 that this direct investment had risen to US\$42.5 billion by the end of 1994 (1,756 companies).<sup>5</sup> This is far more than the combined investments by Japan and the U.S., and places China at the top of investors in Hong Kong.

Consequently, the impact of Chinese enterprises on Hong Kong is substantial. Chairman Shen indicated that Hong Kong-based Chinese companies account for 22 percent of the enclave's total trade, 55 percent of its re-exports to China, 23 percent of its bank deposits, 21 percent of its insurance premium revenues, 22 percent of its freight shipments, 50 percent of travel business to China, 12 percent of construction projects and 5 percent of the total value of investment in the stock market. A look at the financial statements of Chinese companies for the first half of 1995 reveals that performance had slumped across the board due to the economic retrenchment policy in China. Reflecting this, Chinese-related shares, in particular "H shares" (shares of Chinese companies listed on the Hong Kong markets), tumbled. Hong Kong is now very vulnerable to not only political, but also economic trends in China.

Economic integration with China appears in the fluctuations of Chinese business and the growing number of people employed in Chinese businesses. Consequently, the industrial structure of Hong Kong has also changed tremendously. A look

**Fig. 2. Trade among Hong Kong, China, and Third Countries (1995)**

(Unit: HK\$ billion)

### China

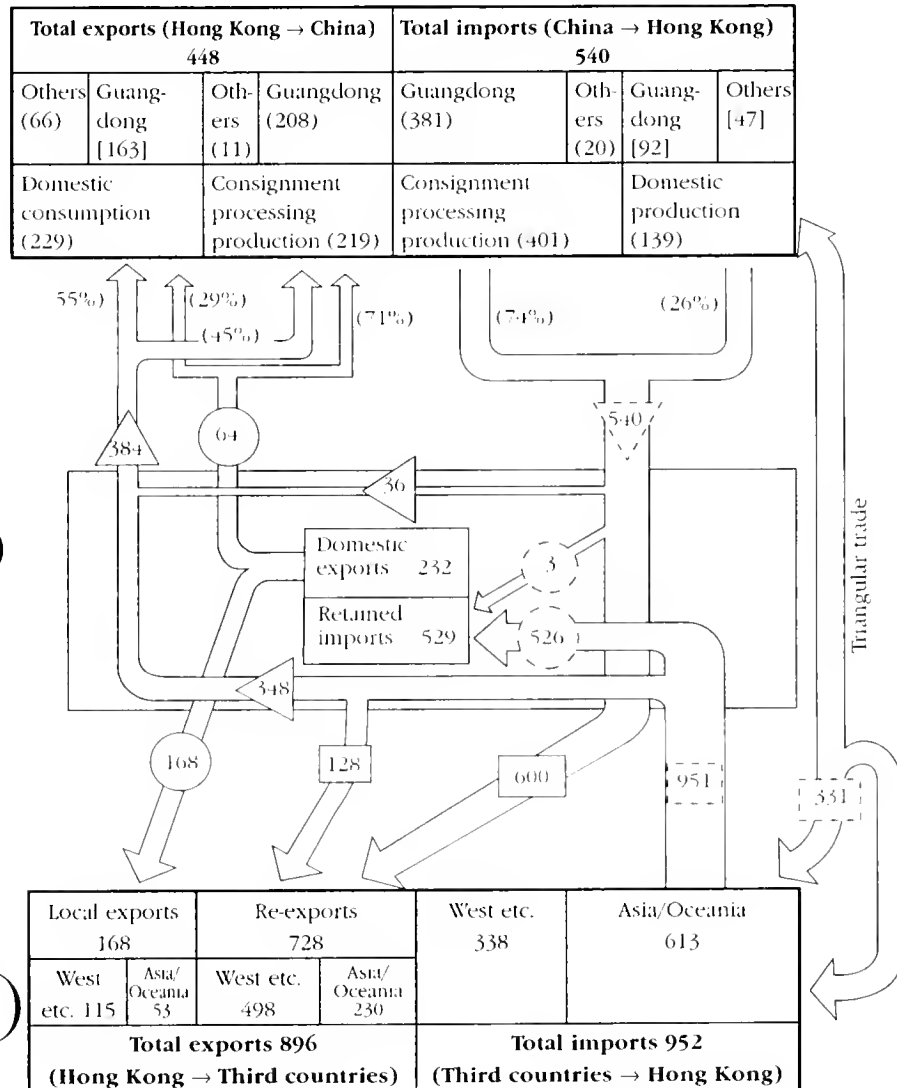
(China's balance of trade with Hong Kong:  
 $540 - (384 + 64) = 92$ )

### Hong Kong

(Hong Kong's trade balance:  
 $1344 - 1491 = -147$ )

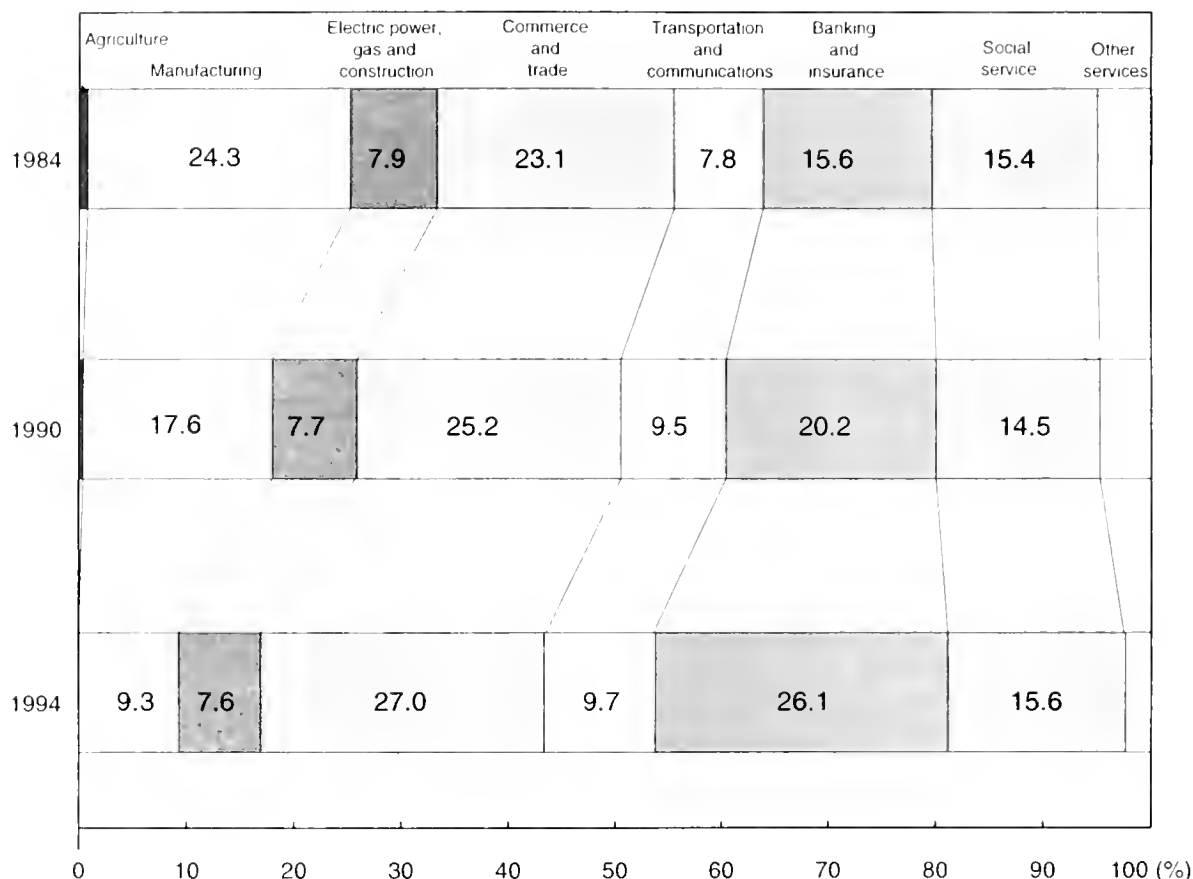
### Third countries

(Entire world excluding China)  
 (World trade balance with Hong Kong:  
 $951 - (168 + 128 + 600) = 55$ )



- Notes:
1. Percentages in parentheses ( ) are findings of the field survey by Hong Kong Census and Statistics Department, while figures in parentheses are estimated values thereof.
  2. Figures in brackets [ ] are estimates using the share of Guangdong in trade of China as a whole with Hong Kong.
  3. Estimates based on the survey of Hong Kong Trade Development Council conducted in 1991.
  4. Based on findings of the survey by Census and Statistics Department (1994), a margin of 18.64 percent was added to re-exports from China through Hong Kong and 11.93 percent to re-exports from third countries through Hong Kong.

- Sources:
1. Census and Statistics Department, "Hong Kong Annual Digest of Statistics 1995," April 1996, Hong Kong.
  2. Census and Statistics Department, "Estimates of Gross Domestic Product 1961-1995," March 1996, Hong Kong.
  3. Hong Kong Trade Development Council, "Survey on Hong Kong Domestic Exports, Re-exports and Triangular Trade," 1992, Hong Kong.
  4. Zhongguo Tongji Nianjian (China Statistics Yearly) 1995.

**Fig. 3. Trends in Industrial Structure: 1984 to 1994**

Source: Same as Fig. 1

over the 10 years from 1984 to 1994 reveals that manufacturing has retreated considerably in Hong Kong and has been replaced by trade, banking and insurance (see Fig. 3). In 1984, manufacturing accounted for 24 percent of the nominal GDP, but fell to 18 percent in 1990 and to single digits, 9 percent, in 1994. The decline in manufacturing is even more evident when the number of workers employed is considered. In 1984, 899,000 workers were employed in manufacturing activities. By 1994, this had dropped to 376,000. In the past 10 years, over half a million workers have in fact left manufacturing for other industries. Conversely, commerce and trade as well as banking and insurance, rose from 23 to 27 percent and from 16 to 26 percent of the GDP between 1984 and 1994, with the number of workers climbing from 574,000 to 1,018 million in commerce and trade and from 170,000 to 378,000 in banking and insurance.<sup>6</sup>

Hong Kong is not waiting for transition of sovereignty in 1997. It is currently changing from an independent economy reliant on manufacturing to a service economy reliant on China.

### ***Shaky Position as Base for China Business***

Considering the close economic relations between Hong Kong and China, it is natural that trends on the mainland have a major effect on the economy of the enclave. The recent slump in the Hong Kong economy, however, cannot be explained that simply. While masked by China's economic austerity program, the role of Hong Kong as a base for doing business in China, a role which has sustained the economy to date, is being threatened by China's striking economic growth, recent

changes in its policies regarding foreign investment and the rising costs in the enclave economy – an economy on par with developed countries.

More specifically, the diversification of trade channels in China had resulted in slower growth in entrepot trade. Until the 1980s, direct investment from foreign corporations had been concentrated in the China's southern region adjoining Hong Kong. Further, due to poor ports and other infrastructure in the coastal areas of China, most trade was funneled through Guangdong and Hong Kong. In the 1990s, however, China increased the pace of reform and opening to the outside world and made improvements in its investment environment leading to a dispersion of foreign direct investment and

trade throughout the country. Accordingly, there has been sluggish growth since 1992 in China-related re-exports through Hong Kong, exports of Chinese products through Hong Kong and re-exports from other countries to China through Hong Kong.

Table 2 illustrates the trends in exports obtained by adjusting Hong Kong export statistics, comprised of domestic exports and re-exports, according to actual economic activities. That is, over half of the value of re-exports in Hong Kong statistics is products made by consignment processing by Hong Kong manufacturers in China. This constitutes exports of products contracted out by Hong Kong manufacturers to adjoining Guangdong

**Table 2. Trends in Exports and Entrepot Trade by Hong Kong Manufacturers: 1978 to 1995**  
(Unit: 100 HK\$, %)

	Exports of Hong Kong manufacturers (A+B)	Local exports (A)	Exports of consignment processing products (B)	Entrepot trade (C+D)	China-related re-exports (C)	Other re-exports (D)
1978	40,700 <75.5%>	40,700 (100.0%)	0 (0.0%)	13,200 <24.5%>	3,868 (29.3%)	9,332 (70.7%)
1991	411,189 <63.2%>	189,426 (46.1%)	221,763 (53.9%)	239,179 <36.8%>	156,931 (65.6%)	82,248 (34.4%)
1992	488,428 <62.5%>	188,087 (38.5%)	300,341 (61.5%)	292,496 <37.5%>	197,349 (67.5%)	95,147 (32.5%)
1993	541,489 <61.3%>	176,135 (32.5%)	365,354 (67.5%)	342,280 <38.7%>	245,787 (71.8%)	96,493 (28.2%)
1994	603,957 <61.2%>	178,532 (29.6%)	425,425 (70.4%)	382,708 <38.8%>	276,434 (72.2%)	106,274 (27.8%)
1995	679,698 <60.5%>	186,279 (27.4%)	493,419 (72.6%)	444,695 <39.5%>	316,535 (71.2%)	128,160 (28.8%)
(Rate of increase over previous year)						
1978-91	19.5%	12.6%	—	25.0%	33.0%	18.2%
1992	18.8%	-0.7%	35.4%	22.3%	25.8%	15.7%
1993	10.9%	-6.4%	21.6%	17.0%	24.5%	1.4%
1994	11.5%	1.4%	16.4%	11.8%	12.5%	10.1%
1995	12.5%	4.3%	16.0%	16.2%	14.5%	20.6%

- Notes. 1. Re-exports of consignment processing products produced by Hong Kong companies in China included in exports of local manufacturers for adjustment of Hong Kong export statistics. Namely:  
 (Exports of Hong Kong manufacturers) = (Domestic exports) - (Domestic exports for consignment processing production) + (Re-export of consignment processing production in China)  
 (Entrepot trade) = (Re-exports) - (Re-exports of consignment processing production in China) - (Re-exports for consignment processing production)
2. Percents in parentheses below export figures represent shares. Figures in triangular brackets < >, however, represent shares of exports of domestic manufacturers and entrepot trade in total exports, while figures in parentheses ( ) represent shares of items in export of Hong Kong manufacturers or entrepot trade.

Source: Prepared from yearly editions of Census and Statistics Department, "Annual Review of Hong Kong External Trade."

plants. It clearly differs in nature from re-export through Hong Kong of products consumed domestically or produced domestically in China, namely, entrepot trade. The re-export of consignment processing products differs in that products are made in Guangdong rather than Hong Kong, but are similar in nature to domestic exports in the sense of being exports by Hong Kong manufacturers. Accordingly, Table 2 adjusts the Hong Kong export statistics, dividing them into exports by local Hong Kong manufacturers and entrepot trade. It further divides the exports by local manufacturers into domestic exports and exports of consignment processing products, and divides entrepot trade into China-related and other trade.

Viewing this table, entrepot trade, in particular China-related re-exports, has slowed in growth since 1991. Having grown by an average annual roughly 20 percent until 1993, China-related re-exports increased by only 12.5 percent in 1994 and 14.5 percent in 1995. Comparing this with the rate of increase in Chinese trade (on a U.S. dollar basis), an average 17.5 percent for 1978 to 1991, 22.0 percent in 1992, 18.2 percent in 1993, 21.0 percent in 1994 and 18.7 percent in 1995, China-related re-exports exceeded overall China trade in terms of the growth rate until 1993, but subsequently dropped considerably below overall trade. Accordingly, the slow pace of growth in entrepot trade since 1994 was not due only to China's economic retrenchment, but was affected by greater competition for Chinese business accompanying diversification of channels for trade with China.

The recent slowing in growth in not only domestic exports, but also consignment processing production by Hong Kong manufacturers in China is more serious for the Hong Kong economy. Hong Kong businesses rapidly increased their consignment processing production in China in the late 1980s to circumvent the higher costs accompanying inflation. As a result, manufacturing activities within Hong Kong itself have been atrophying as discussed in the previous section. Domestic exports also leveled out in 1988. In their place, re-exports of consignment processing products have rapidly risen. The share of exports of consignment processing products in all exports by Hong Kong manufacturers rose as high as 73 percent in 1995. In so far as consignment processing production is considered

from the value of exports, growth began slowing in 1994, which may be understood from Table 2 as well.

The retraction of incentives offered by China to foreign investments and the speed in which Chinese companies are catching up are reasons for this. The change in policy to treat foreign investments the same as domestic enterprises means that incentives provided to date will be successively eliminated. Chinese companies are therefore finding it less and less advantageous to connect with Hong Kong businesses. Accordingly, some of the Chinese enterprises which concluded joint venture agreements with Hong Kong firms in the early 1980s, and are now generating sufficient profits and operating well on their own, have been declining renewal of these agreements upon the expiration of the 10 or 15 year terms of the ventures and have been dumping their Hong Kong partners.<sup>7</sup> Further, some of the Chinese enterprises which had performed consignment processing for Hong Kong firms have acquired production, management, and sales knowledge in the 10 or more years of their association and have decided to go into business for themselves. Cases are now beginning to appear in which partners of Hong Kong firms refuse to do further consignment processing production, another factor behind the slower growth of consignment processing production.

The fact that consignment processing production, the survival strategy of Hong Kong manufacturers, has reached a turning point is inevitable considering the labor-intensive processing and assembly work involved. This will have a large future impact on the Hong Kong economy, however. First, added value remaining in the Hong Kong region will decline. The consignment processing business is designed to make use of the inexpensive, well-trained Chinese labor force. For this reason alone, Hong Kong's losses will be extremely large. Second, the shift of Hong Kong's trade structure from consignment processing production to entrepot trade makes the Hong Kong economy more vulnerable to the economic weight of China.

Another sign of the endangered position of Hong Kong as a base for doing business with China, in addition to the slower growth of consignment processing trade, is the leveling out of the profit margin obtained from such trade. A survey by the Hong Kong authorities found that the gross profit margin obtained from Chinese re-exports, includ-



ing consignment processing and entrepot trade, rose from the 11.5 percent in 1989 to 26.1 percent in 1993, but edged down to 24.9 percent in 1994. The gross profit margin obtained from re-exports with partners other than China fell from the 10.3 percent of 1989 to 5.7 percent in 1994. Even viewing re-exports as a whole, profit margins had risen since 1989, but began declining in 1994.<sup>8</sup>

Chinese factors, such as inflation, the somewhat firmer Chinese rmb and fiercer competition with neighboring countries may be mentioned as factors behind the decline in the gross profit margins in 1994. The recently soaring personnel costs and real estate rents in Hong Kong have also had a major impact, however. Hong Kong firms are working to cut down on labor costs and have recently started moving not only their production plants, but even their administrative offices elsewhere so as to reduce spending. They are fully occupied simply maintaining sales and profit margins at their current levels.<sup>9</sup> In addition, there are a substantial number of upward cost factors in the future Hong Kong economy. The Hong Kong economy has already reached the level of developed countries, and there have been corresponding mounting demands for democratization of the political process. How long will Hong Kong be able to maintain its most attractive features, the inexpensive charges for infrastructure and low tax rates, which have supported it to date? This is also a serious issue when considering the future of Hong Kong.

### *Issues Facing Hong Kong Economy*

When considering the Hong Kong economy after its return, attention tends to be drawn to the transition to the Chinese system, but the issues facing Hong Kong reside rather in the enclave's economy itself. It is true that the free economic and trade system and cheap, efficient infrastructure, which have made Hong Kong's prosperity to date possible will be somewhat spoiled by the transition to the Chinese system and that the uniquely Hong Kong "efficiency," "fairness," "openness" and "decisiveness" will be hampered. Before going into this, however, the Hong Kong economy has already begun to lose its footing as it approaches return, and its role as a base for business with China, which provides the underpinnings for the Hong Kong economy, has already been threatened.

Fortunately, Hong Kong still maintains an unshakable position as an international financial center. The Hong Kong government established the "Hong Kong Monetary Authority" in 1993 to reinforce the enclave's functions as an international center of finance. This worked to stabilize the currency, ensure the safety and stability of the banking system, promote a more streamlined and sound banking system and improve Hong Kong's position as an international banking center. Further, since Hong Kong and China will be one country following its return, some people will view Shanghai as a rival, but it will probably take Shanghai at least 10 to 20 years to catch up with Hong Kong. Accordingly, Hong Kong must decide on its future while it still maintains an unshakable position as an international financial center, and devise measures for dealing with the mounting problems it faces.

First, it is necessary to further improve the infrastructure, namely the port, airport and communications system, both in terms of knowledge and hardware. The authorities announced in October 1989 a large-scale project called the "Port and Airport Development Strategy (PADS)" which is currently underway. There was a fight between China and the U.K. over funding at the time of the announcement, but work will hopefully begin as early as possible. Numerous similar infrastructural development projects are underway in the Pearl River delta, however, so competition will become fiercer in the future. Accordingly, more knowledge in areas of improving efficiency and holding costs down will become increasingly important.

The second issue is the development of human resources. A look at the Hong Kong economy as it now stands reveals inappropriateness of labor due to the speed of the structural changes. Hong Kong will not only have to develop human resources for handling the increased emphasis in its economy on services, but will also have to develop high-quality human resources enabling it to be competitive with nearby countries. The authorities have been increasing the number of universities and their student enrollments and have been offering various types of training through the Vocational Training Council and Employment Retraining Council. Many problems, such as how to educate the average daily influx of 150 Chinese nationals and how to deal with the recently declining English language abilities of the population, remain, however.

The third issue is the revitalization of Hong Kong manufacturing activities, including consignment processing. While the manufacturing's share in the Hong Kong GDP and number of workers has fallen, manufacturing, when consignment processing production is included, still plays a major part in the Hong Kong economy, as is clear from Table 2.<sup>10</sup> Accordingly, it is necessary to either encourage more sophisticated manufacturing activities in Hong Kong or aim at becoming a R&D base for Guangdong and the rest of China southern region which is now evolving into a huge manufacturing base in its own right. The Hong Kong authorities are well aware of this situation, having established investment-related organizations for the manufacturing sector and strengthening the role of the Industry and Technology Development Council, the advisory organization for formulation of industrial assistance programs, to deal with the gutting of the manufacturing sector. They are much more aggressive in doing this than in the past, implementing, for example, an "Industrial Support Fund" aimed at technical development through R&D and the training of human resources in 1991. In whichever case, ending the collapse of the manufacturing sector will require measures encompassing Guangdong and the rest of the hinterlands as well.

As previously explained, the Hong Kong economy is facing problems of an unprecedented severity. No place in Asia, however, enjoys advantages in every regard. It would be meaningless for Hong Kong, which has surpassed even the U.K. with a per capita GDP of US\$23,000, to try to compete with Shanghai, Manila or Bangkok in costs. The

issue is whether it can provide a level of services warranting its higher costs. The "quality" of the economy, therefore, will be questioned most.

### Notes:

- 1 For more details, see Mariko Watanabe, "Henkan o Hikaete – Sakin no Hong Kong Keizai" (On the Brink of Return – The Recent State of the Hong Kong Economy), *Journal of the Japan-China Association for Economy and Trade*, March 1996.
- 2 For the importance of the effect of changes on trade terms on real gross domestic income, see "The Deterioration in Hong Kong's Terms of Trade and its Impact on Real Income," *Hong Kong Economic Indicators*, August 1995, Standard Chartered Bank.
- 3 Census and Statistics Department, "Estimates of Gross Domestic Product 1961-1995," March 1996, Hong Kong, pp. 86 and 87.
- 4 For more details, see *Xinbao*, April 24, 1996 and Hong Kong Trade Development Council, "Survey on Hong Kong Domestic Exports, Re-exports and Triangular Trade," 1992, Hong Kong.
- 5 *Xinbao*, March 17, 1996.
- 6 For trends in the number of workers in different industrial sectors, see Census and Statistics Department, "Hong Kong Monthly Digest of Statistics."
- 7 *Xinbao*, April 24, 1996.
- 8 *Xinbao*, February 29, 1996. See also pp. 72 and 73 of (Note 3).
- 9 See "Rationalization of the Services Industries," *Hong Seng Economic Monthly*, August 1995, Hang Seng Bank Limited.
- 10 See "An Analysis of Hong Kong – China Trade," *Hong Kong Economic Indicators*, April 1994, Standard Chartered Bank.

# Chapter IV

## Borrowed Land : How does the “rug” under the Hong Kong economy work?

*Hong Kong, the capitalist enclave consisting of 236 large and small islands, the Kowloon peninsula and the New Territories at the southern tip of China, is scheduled to be returned to China on July 1, 1997. Agreement on the return of Hong Kong was announced by the Sino-British Joint Declaration on December 19, 1984. Talks between UK and China on the sovereignty problem of the region started in September 1982, 15 years prior to the scheduled end of “lease” terms over the New Territories, the largest part of the colony, in 1997.*

Why 1982? This is also due to a condition related to land in Hong Kong. In Hong Kong, average terms of mortgage loans, which is a major investment item for financial institutions, was 15 years. Therefore, when 1982 rolled around, the year 1997 came into the prospects of people in Hong Kong. Would Britain renew the lease contract? Concern over this problem consequently severely hampered business in the territory. In order to alleviate these concerns, the British government started difficult negotiations with its Chinese counterparts. Eventually in 1984, negotiations were resolved by an agreement that the UK would hand Hong Kong over to China at the end of the term of the lease on the New Territories, though the Chinese government did not formally admit the legitimacy of Britain's rule over the territory.

This article will describe the roles of the “rug,” being put under Hong Kong and to be handed over to the new owner soon. First, mono-ownership of land, a unique characteristic of land management in Hong

Kong, will be described. The supply and demand structure of the property market, and the impact of property on the financial market will then be discussed, the presence of the government being strong in all these areas.

### **Monopoly on Land Ownership: Developing land from land**

Hong Kong has been a colony of the United Kingdom since 1842. The land is theoretically owned by the Queen. To be precise, the Queen owns regions of Hong Kong Island, Kowloon peninsula, as well as being the biggest “tenant” of the New Territories and other islands. The Hong Kong government has exercised ownership rights over land on behalf of the Queen and enjoyed various benefits from these monopolistic rights.

First, the Hong Kong government holds a unique source of fiscal revenue through land sales, though its share is not extremely high. Land-related sources, however, i.e., rates (taxes for public service charged on property value), and transaction taxes, made up a certain amount and stable share of revenue. Figure 1 illustrates ratios of proceeds from land sales, taxes and other land-related



**Public housing: Nests of half Hong Kong population**

items among the colony's fiscal revenue. The share of proceeds from land sales, which may be described as a benefit of monopolized ownership, moved on as follows. It accounted for over 30% of Hong Kong's revenue in 1980 and 1981, when it recorded the highest share. It also accounted for

10% to 20% of total revenue during the other periods. The other land-related revenue items, including real estate transactions tax and rates, accounted for a further 10% to 20% of the colony's fiscal revenue. In all, 20% to 30% of the colony's fiscal revenue is derived from land and property-related items. These items secured a considerable margin of comfort in the Hong Kong government's fiscal management.

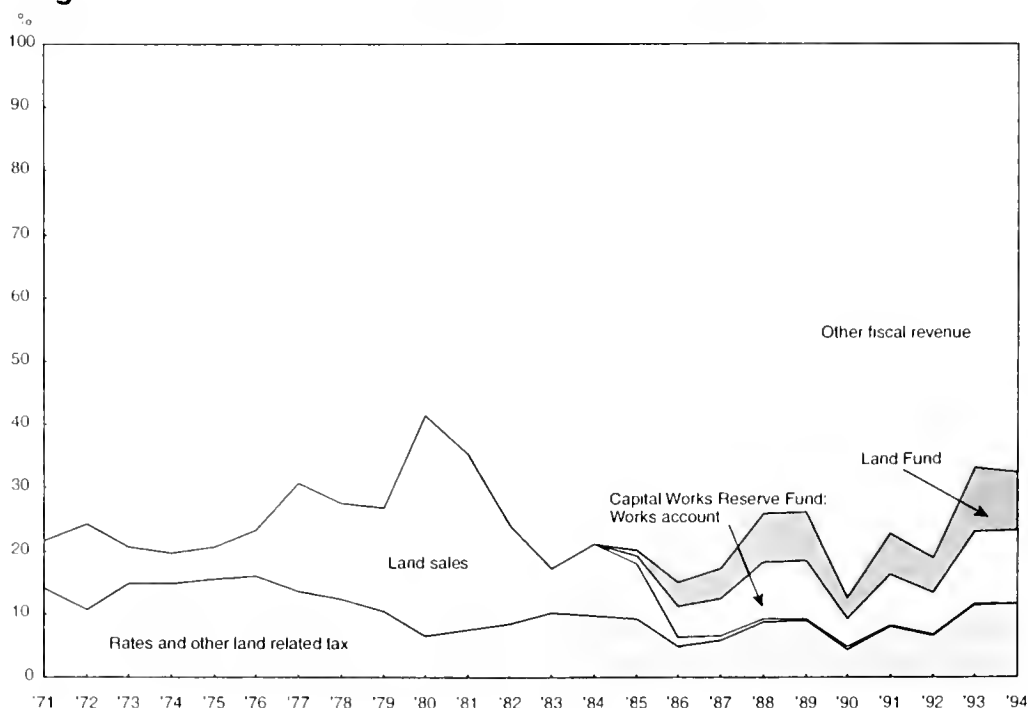
The Chinese government was also well aware of the importance of land-related revenue. The Annex 3 of the Joint Declaration in 1984 provided for the deposit of half of the profit from land rented out after 1997 in the "Land Fund" from 1987, after being credited to the "Suspense Account" in the "Capital Works Reserve Fund," for use by the future Hong Kong Special Administrative Region Government. The remaining half was to be credit in a "Works Account" of the Capital Works Reserve Fund" as the share for the present Hong Kong government. Figure 1 also illustrates a plummeting of proceeds from the sale of land since 1985. This is due to the fact that since 1985 these proceeds have consisted only of land with lease contracts expiring before 1997. Other proceeds are categorized into the Land Fund and the Works Fund in the Capital

Works Reserve Fund. The Joint Declaration also provided other new rules on the sale of land after 1985, limiting the size of land which the government can sell at its discretion to less than 50 hectares a year. At the same time, the declaration required approval by the Sino-British Land Commission, which was established by the declaration, on land sales exceeding the limit of 50 hectares, land use and price, and areas actually leased. The Chinese side has already started to govern Hong Kong on this sphere of land management.

Figure 1 further shows that far from decreasing, the share of land-related fiscal revenue increased especially in the 1990s, despite restriction by the declaration. This reveals an attitude of active gain from land management on the Chinese side. These active land sales brought a massive surplus fund to the Hong Kong government. Though, in a conventional account, the budget was estimated to record a small deficit of 2.5 billion for 1995/96,<sup>1</sup> the Hong Kong government actually enjoyed fiscal surplus when this fund, which was credited to the Land Fund, is taken into account.

Government spending on infrastructure and property also made up a certain amount of total

**Figure 1: Share of Land-Related Items in Fiscal Revenue**



expenditure. Among total government consolidated expenditures, she spent 25% to 30% on construction and building and 10% to 15% on housing. Looking at shares in investment expenditure in GDP terms, the government has spent an average 35% of the total since the 1980s.<sup>2</sup>

In total, the government earns around 20% to 30% of revenue from land, and spends almost the same share of total expenditures on building and construction. The government has developed “land” from “land.” In net terms, the government secured a surplus in the fiscal reserve as well. In this regard, the government has been criticized for keeping property prices artificially high in order to expand their revenue. This argument will not be studied here in detail. Instead, the following two sections will outline supply and demand factors related to property, mainly from a macro point of view.

### ***Property Supply: Mixing public and private actors***

The second feature of land management in Hong Kong is a strong commitment from the government toward the construction of property. The housing problem has been a particularly consistent major target of government public policy during the post-World War II period. This problem is also an extremely common and complicated issue within local society, because housing is a matter of basic need and, moreover, certain housing still remains at an unsatisfactory level. It is rather difficult to get a whole picture of the housing problem in Hong Kong. This is due to the existence of heterogeneous players; public corporation and private companies.

### **Half and half**

Table 1 shows the change in ratios among types of housing since the 1960s. Here you can see that between 30% to 40% of households in Hong Kong have lived in public rental and temporary housing since the 1970s. Other households lived in private permanent (self-contained type) and temporary housing. The former accounted for around 40%, slightly larger than total public housing. The share of private temporary housing decreased from about 10% to 3% during the same period. On the other hand, households living in Housing Authority

Home Ownership Schemes increased its share from 1% to around 10%. In total, the public sector supplied around 40% of domestic property, and increased slightly faster than the private sector.

As a whole, half of the population in Hong Kong is living in public housing, among which the share of owner-occupier is increasing, and the other half are living in private self-contained housing (ratios between rental and ownership among the latter is not available). This share has not basically changed since the 1970s. The private and public sector maintained equal shares of the housing supply at “half and half.”

### **Principles of property suppliers**

Are there then any differences between the targets of these public and private players in the housing supply market in Hong Kong? First, the private sector's principles are very clear. They buy land from the government, build up the property on the sites and supply housing at prices which maximize profits. A report by the Consumer Council investigates whether oligopoly in the private domestic property market in Hong Kong exists, based on analysis of the industrial organization theory.<sup>3</sup> This report points out that developers may be ruining the consumer surplus by exploiting the asymmetry of information. However, the council admits that it could not find sufficient evidence of collusion among developers. It may be correct to argue that private developers are likely to maximize profits through “perfect market competition.” The report proposed seven recommendations for improving the competitiveness of the market structure, including for example, reducing the size of lots in land sales and restricting date controls for selling.

The behavior of public sector players, secondary players in the market, looks more ambiguous, and they seem to follow several principles, sometimes rather contradictory. The government, with sole ownership of land, developed massive public housing and promoted renewals. For example, it supplies land at no charge for housing development by the Housing Authority, an independent public body. It can easily be imagined that without monopolized land ownership by the government, this exceptional treatment of the Housing Authority, or at least maintaining the present size of public housing would be impossible.

**Table 1. Domestic Households by Type of Living Quarters**

Table 1. Domestic Households by Type of Living Quarters										Number of households (thousands)								
	1961	1966	1971	1976	1981	1982	1983	1984	1985									
Type of living quarters																		
Public housing blocks																		
Public and aided rental blocks	=	=	263.2	311.3	340.7	343.1	413.1	33.0	464.7	35.0	489.3	37.0	510.7	37.1	519.5	37.1		
Housing Authority Home Ownership Scheme Estates					-2	1%	13.1	1%	21.0	2%	28.6	2%	40.3	2%	40.3	3%		
Urban improvement scheme blocks															0.3	0.0		
Private housing blocks																		
Self-contained			511.9	60%														
Whole houses/flats	57.4%	9%	372.4	49%	321.9	26%	588.6	45%	583.8	44%	600.4	44%	410.0	29%				
Rooms, bedspaces etc.			275.0	36%			258.1	21%					199.2	14%				
Non-self-contained	12.3	2%	60.9	8%	17.5	2%	6.8	1%	3.3	0.3%	2.6	0.2%	2.8	0.2%	2.0	0.1%		
Villas/bungalows/modern village houses					26.3	2%	29.9	2%	32.9	2%	32.2	2%	36.1	3%				
Simple stone structures	480.0	72%			34.7	4%	57.8	5%	55.8	4%	53.0	4%	53.0	4%	55.5	4%		
Other permanent housing					16.4	2%	31.8	3%	27.1	2%	24.6	2%	28.5	2%	33.1	2%		
Temporary housings																		
Housing Authority cottages/temporary huts					6.9	1%	26.5	2%	29.9	2%	33.5	3%	35.4	3%	36.3	3%		
Private temporary housing	116.9	18%	54.7	7%	88.1	7%	99.2	8%	93.5	7%	87.1	6%	85.3	6%				
Total	666.6	100%	763.0	100%	846.7	100%	990.3	100%	1311.6	100%	1334.3	100%	1378.7	100%	1417.7	100%		
= Figures of public rental blocks are included in private housing blocks during these years and cannot be separated																		
Type of living quarters																		
Public housing blocks																		
Public and aided rental blocks	532.7	36%	544.0	36%	552.2	36%	562.8	36%	578.7	37%	597.1	37%	627.3	38%	631.7	38%	642.1	37%
Housing Authority Home Ownership Scheme Estates	57.6	4%	65.2	4%	79.9	5%	88.5	6%	100.8	6%	117.3	7%	127.3	8%	145.9	9%	172.7	10%
Urban improvement scheme blocks	11.0	1%	1.3	0.1%	1.7	0.1%	2.4	0.2%	3.5	0.2%	3.9	0.2%	5.4	0.3%				
Private housing blocks																		
Self-contained																		
Whole houses/flats	441.1	30%	476.4	32%	512.0	33%	534.2	34%	555.0	36%	569.9	36%	589.6	36%				
Rooms, bedspaces etc.	191.6	13%	167.3	11%	157.7	10%	127.8	8%	114.5	7%	115.2	7%	100.7	6%				
Non-self-contained	3.0	0.2%	2.7	0.2%	1.9	0.1%	0.8	0.1%	0.3	0.0%	0.5	0.0%	0.1	0.0%				
Villas/bungalows/modern village houses	46.4	3%	44.0	3%	45.2	3%	47.0	3%	59.1	4%	61.4	4%	57.4	4%				
Simple stone structures	51.8	4%	50.1	3%	51.2	3%	42.9	3%	36.6	2%	35.5	2%	36.8	2%				
Other permanent housing	29.3	2%	30.1	2%	30.0	2%	33.4	2%	26.7	2%	27.9	2%	26.5	2%				
Temporary housings																		
Housing Authority cottages/temporary huts	36.1	2%	37.3	2%	36.6	2%	35.6	2%	30.4	2%	26.2	2%	23.0	1%	23.9	1%	19.9	1%
Private temporary housing	82.5	6%	77.7	5%	64.2	4%	73.5	5%	53.3	3%	48.2	3%	45.9	3%	42.2	3%	39.9	2%
Total	1473.1	100%	1496.1	100%	1532.6	100%	1549.0	100%	1559.0	100%	1603.1	100%	1640.0	100%	1681.3	100%	1735.5	100%

Note: Excludes domestic households living on-board vessels

Sources: 1. Census Population and By Census Population totals for 1961, 1966, 1971, 1976 and 1981

2. From General Household Surveys (tables in Hong Kong Social and Economic Trends) for 1982-1994

The major public and semi-governmental bodies which are operating in the property-related businesses are: (1) Housing Authority which is building public rental housing, and Home Ownership Scheme flats, (2) Housing Society, which mainly supplies flats for sale and is building Sandwich Class Housing Scheme, Flat-for-Sale Scheme and Urban Improvement Scheme units, (3) Land Development Corporation, which was established in 1985 for the purpose of urban renewal and also provides flats for sale, (4) Metro Transport Railway Corporation, which is a public body responsible for subway management and also provides residential flats on its sites. The cumulative supply of these bodies almost equalled private housing's one year production,<sup>4</sup> and (5) Private Sector Participants Scheme. This scheme is a form of flat production through cooperation between the public and private sectors, also building flats for sale by private sector under certain governmental regulations.

### Criticism on public housing supply

As with the public body players, there are also various criticisms and opinions of government housing and land policies. Some argue this problem from the viewpoint that housing is a commodity supplied under market rules. They tend to criticize the government on its policy related to the domestic property market, regulation of property prices, interest rates and urban development policy. This is completely true of the domestic housing market in which private players supply. Others argue from the standpoint that housing is a basic need that government should supply as public goods. Accordingly, they often criticize the government's ownership promotion policy.

The government housing policy is often criticized for its "planning bias." The government, though it began promoting home ownership in the 1970s, still retains the idea of quantitative management within the Housing Department and the Housing Authority. First, priority given to quantitative planning, mainly based on demographic projections, has long been criticized as one reason for poor housing conditions in Hong Kong.<sup>5</sup>

Chau points out that government constructed housing so blindly that quality was extremely low, especially until the 1970s. The per capita adult space in public housing built at that time was 3.3 square

meters. This constitutes inadequate housing conditions, inferior to the 5.25 square meter space considered a basic need by the ILO.<sup>6</sup> Li and Yu also point out that the government's ill-designed regulations on flexible use of space lead to wasted subsidies, with tenants receiving only four cents value to one dollar spent by the government on public housing in the 1970s.<sup>7</sup> However, it is pointed out that the provision of low-quality housing at prices lower than "equilibrium" improved somewhat with the establishment of the Home Ownership Scheme in the 1970s, under which the government began selling units.

In the 1990s, a problem caused by inefficient allocation came into dispute again in another form. This conflict appeared at both ends of the income scale. The waiting list for public housing is so long that people must wait seven years on average. At the same time, the number of homeless people, who cannot afford to live in private rental housing, and have not yet received public housing units, has increased. At the top end of the income scale, affluent tenants who have become able to afford second houses on the private market, but are still staying in public housing units have become a problem. This phenomena reveals that housing supplied by the government has not worked efficiently enough in terms of distribution. Moreover, this inefficiency may have led to the formation of a public housing-subsidized class, and a non-subsidized class, especially in the long-term.

In order to cope with these misallocation and price appreciation problems, the government implemented several policies. With regard to the former problem, the Housing Authority has announced that they will introduce a new rule for optimal utilization of public housing, with a criteria of asset limits for tenants and investigation of tenants' assets from April 1997.<sup>8</sup>

The government also launched a policy to increase the supply of housing with the implementation of an action plan following the recommendation of the Task Force on Land Supply and Property Prices in 1994, when property prices overwhelmingly appreciated. This plan consists of two parts: a policy to curb speculation and a policy to increase the supply of housing and land. In 1996, the government also announced the Urban Renewal Strategy in June and a plan of Overall Hong Kong Development Strategy, a long-term strategy until

2011, in July. These plans and policies are aimed to expand the supply to market.

Some have criticized a tendency on the part of government which neglects the market mechanism. Anti-Speculation policy has especially invited criticism. Lawrence Lai criticized the anti-speculation policy as just raising search costs, and posits that prices will be determined at a equilibrium level anyway.<sup>9</sup> Fu Yuning argued that the appreciation of property prices was a result of rational behavior in a market environment with high yield rental and low real mortgage interest rate, not simply due to speculators' misbehavior.<sup>10</sup> The second policies, promotion of urban renovation and the increase of housing supply were welcomed as moving on the right track. These measures are also unique to the Hong Kong government.

The factor of demand for property and land in Hong Kong will not be discussed. However, average households in Hong Kong are predicted to be able to invest in property from their income. Demand for property and housing is also subject to change by the investment behavior of households and their life time plans. Next, we will outline asset size with a view toward the structure of demands for asset, including property.

### **Asset Structure of Hong Kong: Property size as an asset**

In an open economy like Hong Kong, it is difficult to trace a whole picture of where people invest their money. However, household and individual portfolios are key factors which affect the demand for property due to the nature of assets, as well as a space consumption goods, or the production factor.

### **Relative size of assets against flow and relative size among assets**

We will lay out here two series of calculations measuring the size of assets. One is the "relative size against flow," size compared with the nominal GDP. The other is "relative size among assets," taking total property value as the numerator.

Table 2 shows outstanding financial assets in Hong Kong, bank assets, equity, debt and total property values since 1985. "Relative size against flow" in this table indicates that banking sector assets are overwhelmingly large in Hong Kong. Total bank assets equalled almost six to seven times

**Table 2. Outstanding Financial Assets and Property Values (denominated by Nominal GDP)**

	1985	*	1988	1990	1991	1992	1993	*	1994	1995
Total Bank Asset	573%	2.46	813%	898%	841%	736%	676%	2.14	720%	706%
(Total Loan)	82%	0.35	89%	104%	108%	104%	107%	0.34	110%	111%
(Loan to property, building)	28%	0.12	32%	44%	49%	47%	50%	0.16	54%	51%
Total Market Capitalization	154%	0.66	128%	112%	142%	171%	332%	1.05	205%	211%
(Equity of Developers)	n.a.	n.a.	n.a.	29%	38%	43%	95%	0.30	52%	56%
Debt	n.a.	n.a.	n.a.	6%	6%	6%	9%	0.03	15%	18%
Total Property Value	232%	1					316%	1		

Sources: Hong Kong Monetary Authority, *Annual Report 1995, 1994*, and other materials distributed at interviews; Commissioner of Rating and Evaluation Department, *Annual Summary*, various issues; Table 3 for Total Property Value.

Note: \* Relative size of assets are denominated by Total Property Value.

**Table 3. Size of property values (denominated with nominal GDP)**

	01/04/85	01/04/89	after 04/06/89	01/04/93	01/10/93
Estimated Total Value of Property	232.4%	291.4%	237.0%	315.8%	367.5%

Sources: Estimates are derived from A Walker, KW' Chau and LWC. Lai, *Hong Kong: Property, Construction and Economy 2nd ed.*, London: Royal Institution of Chartered Surveyors, 1994; *Hong Kong in China: Real Estate in Economy*, Brooke Hillier Parker, 1995.



the GDP after 1988. Outstanding equity, that is total market capitalization, fluctuated between two and four times of the GDP, almost one-third to half of banking sector assets. The debt market in Hong Kong matured in the late 1980s. Outstanding assets are therefore rather small, but have been steadily increasing recently. Among financial assets, people have preferred to invest in the banking sector, with the stock market ranking second.

Table 3 shows property values for 1985, 1989 and 1993.<sup>11</sup> These estimates are based on the assumed discount rate, and its reliability is therefore limited. However, these figures give some hint in understanding the structure of assets in Hong Kong illustrated in Table 2. You can see here that total property values in Hong Kong are smaller than total bank assets, approximately less than half, but were slightly larger than total market capitalization of the stock market in both 1985 and 1993. In 1993, equity values swelled to about 150% of 1985 figures, though other assets remained at the same level. 1993 saw drastic asset appreciation, with some arguing that this was induced by capital flow from mainland China. Data for other years and more precise surveys are required to argue this in more detail. Looking at these figures, however, it is difficult to say that property was not unusually high or volatile from "speculation."

## Comparison with US, UK and Japan

Table 4 summarizes asset size in the U.S., U.K. and Japan in 1985, and Table 5 offers a summary for 1988 to 1994 in Japan.<sup>12</sup> This asset data is derived from asset balance sheets in the National Account and denominated by each nominal national ac-

**Table 4.**  
**Outstanding Assets of US, UK and Japan**  
**(denominated by nominal national income)**

	US		UK		Japan	
	1985		1985		1985	
All financial assets	560%	2.78	857%	3.19	844%	1.62
Equity	76%	0.38	100%	0.37	96%	0.18
Pension funds	56%	0.28	59%	0.22	37%	0.07
All physical assets	402%	1.99	580%	2.16	723%	1.39
Land	92%	0.45	153%	0.57	404%	0.78
Domestic property	110%	0.55	116%	0.43	116%	0.22
Land + Property	202%	1	269%	1	520%	1

Sources: Estimates from Ishikawa (1990), "Wealth of Households and Firms; On concentration of wealth in Japan," in K. Nishimura and Miwa, Y. ed., *Stock and Land Prices in Japan* (in Japanese), University of Tokyo Press, 1990.

count. Therefore, figures in these tables are not exact counterparts of Hong Kong's data in Tables 2 and 3. It can be easily imagined that Hong Kong data includes assets of non-residents of Hong Kong. However, the U.K. also maintains a similar open financial market. This comparison may therefore offer some implications.

First, the U.S. recorded total financial assets of 5.6 times the GDP, the U.K. 8.6 times, and Japan 8.5 times of output. The U.K. and Japan recorded almost the same Total Bank Assets as Hong Kong for 1985. Relative size of financial assets to physical assets are: U.S. 1.4, U.K. 1.5 and Japan 1.2. In Hong Kong, equity plus debt was about 1.1 times of property values in 1993. According to figures here, the size of financial assets in Hong Kong is quite large. Among financial assets, equity in Hong Kong was the largest among the four economies in 1985.

**Table 5. Outstanding Assets: Japan**

	1985	1988	1989	1990	1991	1992	1993	1994
<b>1. Tangible assets</b>	563.2% 1.15	738.9% 1.10	788.0% 1.10	807.6% 1.10	732.1% 1.11	674.7% 1.12	662.9% 1.12	655.7% 1.12
Property	117% 0.36	178% 0.27	183% 0.26	187% 0.25	188% 0.28	193% 0.32	200% 0.34	206% 0.35
(Residential buildings)	49.7% 0.10	48.8% 0.07	50.3% 0.07	50.7% 0.07	49.9% 0.08	49.9% 0.08	51.2% 0.09	52.2% 0.09
Land	313.2% 0.64	492.1% 0.73	534.2% 0.74	550.0% 0.75	473.5% 0.72	412.1% 0.68	392.2% 0.66	380.6% 0.65
Land + Property	490.6% 1	670.1% 1	717.6% 1	736.7% 1	661.9% 1	604.7% 1	592.2% 1	580.8% 1
<b>2. Financial assets</b>	665.2% 1.36	864.0% 1.29	926.5% 1.29	851.9% 1.16	828.5% 1.25	788.8% 1.30	810.2% 1.37	838.2% 1.43
Deposit	154.9% 0.32	180.2% 0.27	186.0% 0.26	185.5% 0.25	183.1% 0.28	184.6% 0.31	190.5% 0.32	195.7% 0.33
Debt	86.1% 0.18	86.1% 0.13	86.1% 0.12	86.1% 0.12	86.1% 0.13	86.1% 0.14	86.1% 0.15	86.1% 0.15
Equity	75.5% 0.15	178.9% 0.27	222.5% 0.31	138.2% 0.19	127.8% 0.19	85.2% 0.14	85.7% 0.14	95.7% 0.16
<b>Total assets</b>	1228.4% 2.50	1602.8% 2.39	1714.5% 2.39	1659.5% 2.25	1560.6% 2.36	1463.6% 2.42	1473.1% 2.49	1493.9% 2.55

Source: Economic Planning Agency, *Annual Report of National Accounts, 1996*

Relative size among assets seems to exist within a different asset structure in Hong Kong than in these economies. In 1985, size of property value in Japan was prominently large, which pushed the size of other assets down. Size of land plus property in Japan during this period amounted to three to six times of the GNP. During this period, Japan experienced extraordinary asset appreciation. It is also interesting that the relative size of U.K. and the U.S. are very similar, with the exception of larger total financial size in the U.K. than in the U.S. When compared to the U.K. and the U.S., Hong Kong's equity size has increased. As far as this data shows, the size of property values in Hong Kong did not reach an extraordinary level, at least not unusual levels as in Japan in the late 1980s. Here again, it is difficult to say that property value and price (numerated by GDP) in Hong Kong, or demand for property, was extremely high.

### *Mortgage Security Corporations and Debt Market Growth*

Nonetheless, as mentioned before, land and property are still important objects of investment by people in Hong Kong. Investment in Hong Kong is somewhat concentrated in the property sector. Loans to property-related projects reached a high share of total loans by financial institutions, affecting the structure of the entire financial market.

As shown in Table 2, loans for property development and investment, though restricted to 10% of total loans by restricted banks, reached almost half of the GDP in 1993. The equity of developers made up around one-fourth of total capitalization, the largest in the industrial classification on the stock exchange. In addition, this does not reflect company development activities classified into other industrial sectors. Similarly, investment in both indirect and direct finance relies not negligibly on property-related projects. Thus, fluctuating property values have affected the economy seriously. A fall in real estate prices reduces bank assets and could therefore induce a liquidity crisis in the economy as a whole, which Hong Kong has repeatedly experienced in the past. A drop in property prices in the mid 1960s threatened the liquidity of a large number of banks, with rumors of bankruptcy causing depositors to run to banks. At this time, the Hang Seng Bank, the largest local bank then, experienced

a run on deposits and ended in merging with the Hong Kong Shanghai Bank, despite the soundness of its actual state of operation and finances.

This excessive reliance on real estate financing and its tendency to trigger liquidity crises was a vulnerability in the Hong Kong financial market. Several measures have been implemented in order to solve this problem, and this movement will end with recent changes in the financial market in Hong Kong and the growth of the debt market in Hong Kong.

Securing massive mortgage loans is a measure to improve liquidity in the financial market. In 1994, two American banks issued mortgage securities in Hong Kong. The government also submitted a plan to establish a mortgage corporation which will be publicly financed, for purchasing mortgage securities. According to a detailed proposal by the Hong Kong Monetary Authority,<sup>15</sup> initial capital of HK\$1 billion would be drawn from the Exchange Fund and the capital/asset ratio would be set at 5%. The corporation would therefore be able to purchase up to HK\$20 billion in mortgage loans, approximately 6% of current real estate-secured loans, and 2% of the 1995 nominal GDP. Through this corporation, banks, especially medium and small banks, would be able to liquidate their real estate-secured assets.

Opinions are split as to whether the establishment of such a securities corporation will be advantageous to home buyers. As discussed before, the size of property assets is not extremely large at this stage, especially compared with financial assets. It is difficult to say that a bubble in property prices exists even in 1993, when property price appreciation was extreme after 1990. It is also difficult therefore to say that this securization plan will escalate asset appreciation. On the other hand, under a privatization policy of public housing flats, outstanding mortgage loans are expected to increase, which could lead to a liquidation crisis in the future. Taking both needs and safety into consideration, this mortgage security program has a rational basis.

Furthermore, this also contributes to the promotion of debt market growth. In 1989, the government started to encourage bond market growth by issuing Exchange Fund Bills and Notes intended to strengthen Hong Kong's financial market. The establishment of Mandatory Provident Funds at the end

of 1996 means the appearance of major institutional players in the long-term fund market, which will collect 5 to 10% of wages as insurance premiums and is estimated to reach a total of HK\$40 billion a year at the end of 1997. Large investors in long-term funds, which Hong Kong's financial market lacked, are also expected to enhance the functions of long-term markets and the Hong Kong financial market as a whole.

### Concluding Remarks

"Borrowed land" served as a source and a form of wealth in Hong Kong. The rising or falling of the value of this land in the future will be a direct indicator of the trends in the Hong Kong economy after the hand-over.

The size of government account funds will possibly become a particularly important factor in the future of the Hong Kong economy. Future fiscal conditions of the SAR government are predicted to remain very sound, though very pessimistic opinions do exist. The Financial Secretary also expressed an optimistic fiscal position, including the establishment of the Land Fund which will register HK\$ 150 billion and \$365 billion surpluses at the end of March 1997 and 2000, respectively.<sup>14</sup> The Hong Kong government has several funds in its capital account which could be utilized as management sources for the SAR government. The "Exchange Fund," which was formed to maintain the value of the Hong Kong dollar, recorded total assets of HK\$ 460.7 billion (256% of the GDP) and a cumulative balance surplus HK\$160.1 billion<sup>15</sup> (89% of the 1995 GDP) at the end of 1995. Practically, this fund has been managed as a internal "bank" of government, and this surplus includes the government "savings" fund of HK\$125.9 billion, a credit from the current account surplus. As described earlier, two land-related funds, the Land Fund (cumulative balance surplus as of the end of 1995 of HK\$85.0 billion,<sup>16</sup> equal to 47% of GDP) and the Capital Works Reserve Fund have recorded large surpluses. Note that, as of July 1, 1997, the Land Fund will be incorporated into the Capital Works Reserve Fund, with the SAR government forecast to record large saving surpluses.

Structural change in local social politics are pressuring the government to change its conservative policy. Pressure on the government to form an

allowance for senior citizens has emerged as discussed in another chapter. Demand for government commitment to smooth industrial structural change, in addition to construction of a "conventional" infrastructure has also emerged.

To date, an opinion exists that the conservative fiscal management and government infrastructure construction has not caused serious economic problems in terms of the shrinking or crowding out of effective demand. However, this may not be completely true. The government surplus has partly been achieved with stable revenue from land and property-related items as discussed here, and government could maintain high reserve funds without raising tax rates. It may, however, be time to reconsider fiscal management policy and make a stronger commitment to structural societal changes, some of which are dependent on the hand-over of Hong Kong and others independent from it.

### Notes:

1. *The 1996-97 Budget Speech by Financial Secretary*, The 1995/96 Outturn, Sec.23.
2. Walker, A. Chau K. W., and L.W.C. Lai, *Hong Kong: Real Estate in the Economy*, Brooke Hillier Parker, 1994. Table 3.15 and Table 3.16.
3. Consumer Council, *How Competitive is the Private Residential Property Market?*, July 1996.
4. *Ibid.*, Annex 3, note 1.
5. L.C. Chau, "Public Housing," in H.C.Y. Ho and L.C. Chau ed., *The Economic System of Hong Kong*, Asian Research Service, 1988/L.C. Chau, *The Growth Impact of Hong Kong's Housing Sector*, a paper presented at the Conference of the Southern Economics Association, 1992/ Li, S. M. and F.L. Yu, *A Study of Hong Kong's Urban Problems (in Chinese)*, Commercial Press, Hong Kong 1986, / Lawrence W.C. Lai, "The Property Price Crisis," in MacMillen, D.H. and S.W. Man ed., *The Other Hong Kong Report 1994*, The Chinese University Press.
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*Kong Report 1994*, The Chinese University Press, pp206-207

- 10 Yuming Fu, "Housing Market and Housing Prices," in Stephen Y.L. Cheung and Stephen M.H. Sze ed., *The Other Hong Kong Report 1995*, The Chinese University Press

- 11 Estimates by Walker, Chau and Lai<sup>11</sup> are used here. This property value is derived from the Rateable Value, which the Rating and Evaluation Department assessed for the purpose of rate charges, capitalized by an assumed capitalization rate./ Walker, A. Chau K. W. and L.W.C. Lai, Hong Kong, Real Estate in the Economy, Brooke Hillier Parker, 1994 Table 3.1 and Annex 3/ Walker, A., K.W. Chau and L.W.C. Lai, Hong Kong Property Construction and Economy 2nd ed., Royal Institution of Chartered Surveyors, 1990 Table 3.1

- 12 Estimation method differs in 1985 from the other years. In 1985, the size of pension funds is reestimated for the other items.

- 13 Hong Kong Monetary Authority, *Mortgage Corporation Proposal*, April 1996.

- 14 *The 1996-97 Budget Speech by Financial Secretary*, Medium Range Forecast, Sec. 87. A Chinese representative revealed at the China Britain Land Commission that Land Fund stocks will reach 100 million on 1st July, 1997. *Hong Kong Economic Times*, 18 September 1996.

- 15 Hong Kong Monetary Authority, *Monthly Statistical Bulletin*, 1996 April

- 16 The use and form of Land Fund under SAR government is still under dispute

# Chapter V

## What Does 1997 Mean to Japanese Businesses?

*During the period from 1995 to 1996, the Japanese, U.S. and U.K. Chambers of Commerce in Hong Kong conducted surveys of the future confidence of Hong Kong. A conclusion in common is that the business environment in post-return Hong Kong would be optimistic.*

The American Chamber of Commerce in Hong Kong conducted a survey of its 1,118 member companies from August to October 1995 (48% response rate). It reported that 74 percent of respondents felt the environment for business in Hong Kong in the next five years would be "favorable," and 17 percent "very favorable." Regarding their business plans for the next three years, 46 percent revealed that they would be increasing investment activities, and 45 percent answered that they would be maintaining business to date. Only 8 percent responded that they would gradually reduce their activities in Hong Kong, and 1 percent that they were planning to withdraw from Hong Kong.

The British Chamber of Commerce in Hong Kong conducted a similar survey from January to March 1996 and reported that 98 percent respondents were going to keep on operating in Hong Kong in the year 2000.

The Hong Kong Japanese Chamber of Commerce and Industry's survey was also conducted in July 1995 covering 745 companies (response rate of 60%) and resulted in similar findings. Seventy-seven percent of the respondents indicated they felt the environment in Hong Kong in the next five years would be "promising," and 8 percent that it would be "extremely promising." Only a low 15 percent felt it would "not be promising." The low percentages of respondents indicating prospects would be either "extremely promising" or "not promising at all" in the Japanese survey reflects a cautious stance in assessing the future of Hong Kong. In response to their personnel plans for the next three years, 47 percent of the respondents stated they were going to increase employment, 44 percent that they would maintain current levels, and only 9 percent that they would be cutting back. The overwhelming majority

of companies, therefore, will either maintain their current business conditions or expand.

### *Factors of Concern over the Deterioration of Conditions*

The findings of these surveys dovetail opinions which I find in daily conversations with Japanese businessmen in Hong Kong. The majority of them are optimistic. Many of them expect, however, some changes in the function of Hong Kong as an international business center. And there is evidence which supported its prosperity to date.

The British survey, the most current of the three, gives a current assessment of 16 factors concerning Hong Kong's future: the legal system, availability of skilled labor, English, the physical infrastructure, business efficiency, facilities and quality of education for children, low corporate and personal tax rates, corruption, availability of a cheap labor force, government administration, communications network, the pegged Hong Kong dollar exchange system, freedom of the press, social stability and quality of life. They also give an analysis of prospects for the future. According to the survey, 86 percent of the companies responding to the survey indicated they were satisfied with all of the factors. Fifty-four percent stated that these were "very good" or "superior."

As for the future, 46 percent of respondents replied that the majority of these factors would remain unchanged, but 86 percent believed that corruption would increase and 71 percent that the function of government administration would deteriorate. Many also predicted that freedom of the press, quality of life, the legal system, social stability, international schools and the level of English would decline.

The Japanese survey revealed that the factors of most concern after 1997 were, social stability (66%), maintenance of the peg system (44%), change of the tax rates (42%), voluntary restrictions on the press (39%), trends in real estate prices (38%), function as a financial center (38%), election

of Chief Executive of the Special Administrative Region (20%), Sino-American relations (17%), English comprehension (16%) and inflation in China (16%). The survey revealed at the same time that respondents are basically either "satisfied" or "somewhat satisfied" with all the present situation of the above items, except for the trends in real estate prices. The Japanese Chamber of Commerce analyzes that the contrasting views between present and 1997 indicated concerns of Japanese over the future of Hong Kong.

### ***Optimism and Pessimism***

Companies and individuals doing business in Hong Kong are extremely sensitive to openly expressing their opinions on Hong Kong's hand-over. A manager of one research company in Hong Kong told me that no one would say what they were really thinking (in response to survey questions), because, as you may easily suppose, they are concerned about what China will think. Even non-Hong Kong companies are no exception. On the other hand, businessmen inherently tend to be positive in regard to the future. Anyone thinking negatively would have stopped doing business or would have moved from Hong Kong long ago. Opinions regarding the future also tend to be optimistic as a result of one's own hopes and expectations and tend to be pessimistic if they have actually faced bad experiences or disillusionment.

Predictions about Hong Kong after its hand-over are, therefore, easily subject to hopes and aspirations about China, making it difficult to be objective. In May 1996, I conducted interviews with Japanese businessmen in Hong Kong on the condition that names be kept confidential, realizing the limitation to the survey and statements regarding hand-over.

A comparison of opinions of the optimists and pessimists regarding post-return Hong Kong reveals that the crux is whether China can be reliable. Both those who are optimistic and pessimistic believe that after the return of sovereignty, some problems will surely occur, such as a decline in the level of peace and order, corruption and a decline in English proficiency.

The opinion of Mr. Overholt of Bankers Trust Hong Kong, a leading optimist, is that China could be reliable concerning the take-over of Hong Kong

and that the "one country, two system" formula will work, since (1) Hong Kong has served vital economic interests of China, and China had maintained its policy to protect Hong Kong's function even at the time of crisis like, e.g. Communist Revolution or Cultural Revolution, (2) China has an excellent record in honoring past international agreements, and (3) the success of "one country, two system" formula will form the basis for problems in reunification with Taiwan. Nonetheless, matters such as the deterioration of peace and order, increased corruption, opposition over interpretations on the Basic Law, confusion concerning a shift of official judicial language from English to Chinese may become a problem, and freedom of the press will remain sensitive. (refer to *Doing Business in Today's Hong Kong*, the American Chamber of Commerce in Hong Kong).

A leading pessimist, Mr. Rasei Ishikawa, believes that China cannot be reliable, because (1) united front maneuvers of the Communist Party are apparent in Chinese history from 1949 and in Tibet, (2) the instability of its promises and laws, (3) the intervention which has already begun, such as pressure on the mass media and demands for changes in the human rights law, and that after the return Chinese interference will create a crisis in the free business environment (see Rasei Ishikawa, 1997 *Hong Kong, Chugoku Daishototsu* (1997 Hong Kong and China Collision), published by Sogo Horei).

Taking these opinions into consideration, I asked Japanese businessmen the following questions: (1) will the "one country, two system" formula work effectively and can China be reliable, (2) will the role of Hong Kong (as a channel for business with China, an international financial center, base for business in East Asia, etc.) change after hand-over, (3) are there any matters concerning transitional process of hand-over which could become a problem, (4) will these problems impair the role and function of Hong Kong, and (5) will this also affect business?

### ***Current System Will Not Change Immediately***

A majority of the respondent replied that China will respect the "one country, two system" formula and allow the Hong Kong people to govern

themselves. The reasons are that China is now internationalizing and opening, and therefore coming around to international opinion, and that the central Chinese government fully understands the importance of Hong Kong. With respect to individual issues, however, others point out that unintentional intervention may occur and hope that there will be no change in the Chinese leaders who understand the situation in Hong Kong. The typical opinion is that while there may be some confusion in the transitional period, it will not be decisive and the current system will not change immediately. Some believe, however, that there may be interference since the Chinese tend to change their policies so often, unlike German reunification, the poorer side will absorb the wealthy one, economic disparity is so wide, and the ways of thinking on both sides are completely different. There is also fear over the tendency of China to overreact to the issue of democracy.

Most businessmen believe that there will be no change in the function of Hong Kong as an international business center even after its return. Hong Kong has been provided with not only the hardware and the settlement abilities for functioning as a center of international business, but also a vast economic hinterlands, free exchange of information, a well-designed legal and financial system with well-experienced accountants and lawyers, and domestic and overseas investors. Enjoying these conditions, Hong Kong will continue functioning.

Regarding the question on competition with Singapore, Shanghai, Kaohsiung and other cities, the number of business centers will naturally increase with the growth and diversification of Asian economies, and investors and businessmen will make flexible use of them according to their specific features and their individual objectives. While some point out that Shanghai could take the place of present Hong Kong, others doubt Shanghai's social environment, including peace and order and corruption by bureaucrats.

### ***Expanding Sphere Under the Influence of China***

The fact that China's influence will strengthen after return is widely acknowledged. Some point out from their experience in business with China that, Chinese appear to deal with issues first emo-

tionally, next rationally and then legally. Great Britain has regulated activities in Hong Kong by legal rule. After the transition of sovereignty, legal rule will give way somewhat to the rule of personal contacts (*guanxi*). Nonetheless, as British people also has been doing business relying on personal contacts to certain extent, some believe that corruption will not necessarily increase in the future.

As for the peg system of the Hong Kong dollar with the US dollar, most businessmen expect that there will be no short-term change in the peg system as long as factors which necessitate the system remains unchanged, but some predict that the object of pegging might switch from the U.S. dollar to a basket of currencies including the renminbi. In the long run, moreover, there remains the problem of when these shifts will happen. Japanese businessmen have been advised by their accountants not to put excess funds in Hong Kong.

Many Japanese are concerned about encroachment on the freedom of the press, which, they believe, would be most severely damaged by the hand-over. Some point out that Hong Kong journalists has been already restraining themselves voluntarily, and newspapers are losing their own individuality and interest. If China overreacts or takes a hard-line stance, intellectuals in Hong Kong society may stage a mass exodus, which may in turn threaten the capability of Hong Kong. Businessmen wish for China to take a patient approach. The majority opinion regarding the potential exodus of manpower is that people who cannot endure the situation will leave, but that the majority will stay in Hong Kong due to its many opportunities of business.

Many Japanese businessmen believe that there will not be a rapid decline in English proficiency due to the need for English even after hand-over. Regarding the tax system, some believe that it is difficult to completely deny the possibility of changes in the tax system, taking the disparities among domestic economic powers in China into consideration.

### ***Even So, Hong Kong***

All companies agree that they should continue to operate in Hong Kong, despite recognizing some possible risks after hand-over. The reasons are twofold. While Hong Kong may lose some of its attrac-

tiveness due to the risks, it will still maintain its advantage over other regions. Some businessmen stand on the side that these risks will not have much of an effect on business activities per se. Most manufacturers engaged in production in China believe that the business environment will not change significantly.

On the other hand, some expect the hand-over to produce some new business opportunities. China will become more accessible and Chinese capital will increase its share in the economy replacing the British, thereby increasing the number of players. The peg system of the currency to a currency basket will create a new exchange market. It should also be noted that the British survey concluded that low-cost labor would become easier to secure.

Another common opinion is that it will be very important to deal with the changes in the social and economic structure of Hong Kong, which have become problems, regardless of the risks concerning hand-over. Personnel and real estate costs are reaching their limits. The Japanese survey found a large number of businessmen dissatisfied with the high rents and prices of property for office and housing. The number of regulations are also growing, such as the requirement for installation of purification equipment.

Further, the following issues should be added to a list of future concerns: (1) the environment, (2) welfare and (3) investment in human resources. Most believe that burdens from these costs will become problematic in the future.

### ***What to Do, Not What Will Happen***

Finally, I would like to introduce two interesting opinions to conclude this chapter.

The gist of the first opinion is that we should consider the length of time in the return of Hong



**Wong Tai Sin: Pray for the future**

Kong. For example, it is natural to think that, in the long run, China will behave more in line with international norms. Prediction concerning competition with Shanghai will change according to the length of period considered.

The second is that we should concentrate on should be done for Hong Kong to grow steadily into the 21st century, instead of being concerned about what will happen. Action toward this aim should be taken. This is the point that the Japanese community, which has played a not small role in the Hong Kong economy, should consider first.



# Chapter VI

## Rising Cost of Social Welfare: Bill Coming Due on Laissez-Faire Policy

*Late February of this year, an unusual cold wave hit Hong Kong. At Tai Mo Shan in the New Territories, temperatures fell to a record  $-4^{\circ}\text{C}$ . Even on the city streets, temperatures dropped to as low as  $5.3^{\circ}\text{C}$ . In subtropic Hong Kong, where the average temperature for February is no lower than about  $12^{\circ}\text{C}$ , this drop in temperature was detrimental to the sick and elderly. In a five-day period, over 60 homeless and elderly citizens died.*

The Hong Kong government placed 71 homeless in the custody of temporary shelters and called upon senior citizens living alone to exercise caution over their health. Members of the Legislative Council, Hong Kong's Congress, particularly from Democratic Party, lodged strong criticism about what they claimed was a lackluster government relief effort. They even began to threaten to withhold approval of the government's fiscal 1996 budget unless authorities improved welfare benefits for senior citizens.

Social security for the elderly has currently become a focus of political activism not merely due to the deaths resulting from the cold wave. With return to China fast approaching, British authorities are being pressed to make a wide range of changes. There is not only external pressure from China, but also pressure from within the Hong Kong community. Both of these play important roles in instigating change. The debate in the Legislative Council reflects these forces.

In this chapter, the history behind the social welfare policies of the Hong Kong government will be summarized. The process leading up to the recent politicization of the issue of welfare for the elderly will then be analyzed.

### **Origin of Social Welfare Services**

The basic governing philosophy of the Hong Kong government has always been one of laissez-faire. As a result, unlike other Asian NIEs, Hong Kong has always maintained "small government" operating on the policy of minimal intervention.



**A Sunday afternoon**

This principle has allowed the business sector to operate freely and has contributed much to the high rate of economic growth in the colony. At the same time, however, it demands the same level of free competition in the general population as it does of business. Currently, for example, Hong Kong does not have a minimum wage, and there are no legal restrictions over working hours except for children and women. In social security, the government has concerned itself only with ensuring a minimal standard of living in order to maintain social stability. No compulsory national pension plans existed in the past; neither did a national health insurance system. Instead, government hospitals offer low-cost diagnosis and treatment to ensure a minimal level of health in the population.

Such government social welfare originated from the need for relief for refugees. Huge numbers of refugees have flooded into Hong Kong beginning during the civil war between the Nationalists and Communists and continuing through the establishment of the PRC, the Great Leap Forward, and other upheavals on mainland China. In 1945, Hong Kong's population decreased to 600,000 during the Japanese occupation. By the end of the 1950s, this had swelled four-fold to 2.36 million. At the time, the focus of the government's social welfare programs turned to the provision of food and other emergency supplies to refugees and the construction of temporary housing for them.

It was not until 1957 that the Social Welfare Department was established to oversee these activities. The principle which was then adopted, however, left the final responsibility for relief of those in difficulty with their families. Hong Kong's first white paper on social welfare, "The Aims and Policy for Social Welfare in Hong Kong," released in 1965, stressed the traditional Chinese concept of "filial piety" and the custom of mutual aid, and incorporated the optimistic belief that poverty, social instability, and even the effects of natural disasters, could be handled through mutual aid among family members.

### *First Change in Policy*

Change was forced in this government policy beginning at the end of the 1960s, triggered by two riots in the middle of the 1960s. The Hong Kong government forcibly quelled the riots, but at the same time tried to improve social welfare to prevent reoccurrence. First, the government invited welfare experts from the United Kingdom, and studied broadening social welfare benefits from refugees to include lower income earners and the elderly. At that time, a change from the provision of relief supplies to cash was decided on. Beginning in 1971, lower income earners and senior citizens were also provided with subsidies for daily necessities.

At the same time, the government strengthened its indirect control over private charity organizations. Private charity organizations play an important role even now as providers of welfare services. In 1995, close to 90 percent of the people engaged in social work belonged to a private charity organization. Only 10 percent worked directly for the government. The government began to increase subsidies to these organizations in the 1970s and guaranteed their workers treatment similar to civil servants in an effort to improve social welfare services indirectly.

### *Unease over the Growing Number of Elderly and Jobless*

In the 1980s, however, criticism began to mount over existing welfare services. The most heated issue was programs for the elderly. Hong Kong, like Japan, experienced an increase in the

average lifespan and drop in the birth rate in the process of its rapid economic growth. The average lifespan for people in Hong Kong is currently 75 years for men and 80 years for women – one of the highest levels in Asia. The birth rate, at the same time, has fallen to 1.2 percent. As a result, 840,000 of the population were over 60 years old as of 1995. The ratio of the population over 65 to the working age population (15 to 64) has also risen to 13.5 percent. In addition, refugees who had rushed to the colony in the 1950s have now reached retirement age. This has increased the urgency of care for the elderly.

This problem has been aggravated by the change in the industrial structure. Manufacturers who had previously instigated the industrialization of Hong Kong have all moved their production plants to mainland China. Ten years ago, the manufacturing sector accounted for 22.6 percent of the enclave's GDP. Today, this has fallen to 10 percent. The percentage of workers in this sector has fallen from close to 40 percent in 1986 to lower than 17 percent today. In other words, workers in Hong Kong have been transferred from manufacturing to other jobs. A large percentage of manufacturing sector workers are middle-aged or older, however, and are finding it difficult to obtain new jobs.

The service sector (78% of GDP), which has played an important role in absorbing the labor force, has been pressed since last year to rationalize due to rising business costs and falling personal consumption. In the four years prior to 1994, the average growth rate in employment in the service sector had stood at 5.2 percent. In 1995, however, this fell to only 2 percent. The unemployment rate had also hovered at about 2 percent in the late 1980s, but rose last year to 3.6 percent – the first time it has climbed to 3 percent in a long while. As a result, "poor senior citizens" have become a focal point of social concern.

### *Government Social Welfare*

In response to this, the Hong Kong government has made changes within its existing service framework. First, it raised the allowance provided to residents over 70 years of age to HK\$510. Further, it launched its "comprehensive social security assistance scheme" on January 7, 1993 in order to integrate existing public aid programs and steadily

increase the amount of payments made under them. In 1994, the government disbursed a total of HK\$2.443 billion. In 1995, this rose to HK\$3.427 billion. During the same period, it raised the average disbursement from HK\$23.27 million to HK\$26.57 million per case. Currently, 100,000 of the 840,000 senior citizens in Hong Kong receive some type of public assistance. Sixty-seven percent of the beneficiaries of the comprehensive social security assistance scheme are elderly.

The government has also enacted a new policy toward private charity organizations. Its previous guarantee of treatment similar to that of civil servants stabilized the positions of workers in such organizations, but resulted in civil servant-like attitudes and led to the bureaucratization of welfare services. In order to solve this problem, the government has proposed to subsidize on the basis not only of input criteria set by the government as was done in the past, but also of the output of the activities of individual charity organizations. In 1995, the government announced plans to experiment with increasing the discretionary authority of charity organizations over the use of subsidies, conditional on assessments of the results of their activities.

When Governor Patten took office, he accelerated efforts to strengthen the social welfare system. The government budget for fiscal 1996, announced on March 1 of this year, included much higher allocations for social welfare than the previous year (increased 20.8%). This tendency of increasing social security costs for the elderly and other needy will most likely continue to rise in the future.

### ***Mounting Demands for Social Welfare***

Despite these steps, demands toward the government's social security policy have been rapidly increasing. The birth of political parties and the implementation of direct elections have promoted such a tendency. Direct elections were first introduced in 1991. Governor Patten's reform resulted in increasing the members of constituencies over 20 fold for the elections of the Legislative Council in September 1995. Accordingly, unlike previously when members of the legislature were appointed by the governor, the candidates of different political parties paid close attention to the needs of the general public. A look at the promises made by

candidates elected in 1995 reveals that they were less ideological in nature and more oriented toward increasing welfare benefits, such as stopping the import of foreign labor, opposing hikes in medical fees of the public hospitals and introducing a pension system, namely, direct concerns of the general public.

In the elections of the Legislative Council of 1995, the Democrats made great strides and became the leading party (though the governor remained in charge). One of the groups supporting the election of Democratic candidates was the social welfare organizations. Even leftist labor unions, which generally support the pro-China faction, have been calling for increased welfare benefits for workers and demanding greater social security for retirees. These changes in the political environment are behind demands for fundamental reform of the welfare system by the government.

### ***Introduction of a Mandatory Provident Fund System***

The Legislative Council has been warring with the government since 1992 over protection of the elderly. This reflects changes in the system described above. The idea of establishing a community-wide system for retirees is not new, having first been proposed in the Legislative Council in 1974. It has subsequently been discussed several times throughout the 1980s. The Hong Kong government, however, had adopted the business community's stance that compulsory participation in a national pension scheme would be tantamount to compulsory savings, therefore restricting the free use of funds of businesses and private individuals. It also claimed that it could not take responsibility for long-term funds due to its approaching return of sovereignty. As a result, the government has continued to reject the establishment of a public fund.

Due to the aging of the population, the changes in the industrial structure and the effects of direct elections, however, beginning in 1991 calls once again rose from labor unions, welfare-related volunteer organizations and other groups for the introduction of a public pension system. In response, in November of the same year, the Secretary of Education and Manpower announced that the government had decided to begin drafting a community pension scheme. In October of 1992, the

government issued a bill for the establishment of a compulsory pension system for the entire community. This proposal, however, was traditionally opposed by the business community, as well as criticized by the welfare sector as not relieving the current difficulties faced by senior citizens. The fact that the government would not assume final responsibility for the management and supervision of the fund posed another problem.

Governor Patten's proposal for an old-age pension arose next in December 1993. According to the draft bill released in June 1994, this plan would have featured (1) a low pension fund premium (1.5% of salaries paid by the business owner and worker), (2) immediate payments to the elderly, and (3) HK \$10 billion in governmental provisions for the initial funding.

The business community, however, opposed the plan as leading to rising personnel costs. Further, the question of who would be responsible for operating and managing the system to counter long-term inflation remained unanswered. China denounced the proposal through the leftist media claiming that the plan was a plot to force the future government of the special administrative region into a deficit. In the end, the government withdrew the plan in January 1995 claiming that a sufficient consensus had not been reached in the public during the three-month period of discussion.

Faced with this turnabout in policy by the government, Democratic Party, social welfare groups and the labor community organized protests. In June of the same year, the government consequently revised the Community-wide Mandatory Provident Fund plan and submitted it to the Legislative Council.

Democratic Party and leftist labor unions opposed the plan, demanding instead the revival of the old-age pension scheme and increase of allowances for the elderly (to over HK\$2,000 per month). On July 27, 1995, however, the government proposal was approved at the Legislative Council. In November of last year, budgetary allocation for the Mandatory Provident Fund scheme was passed by a slight margin of 30 to 26. In February and April of this year, budgetary allocations for the establishment of the Mandatory Provident Fund Office were also passed – again by slight margins.

Time played an important role in bringing about this result. If the current government proposal failed, it was clear that the establishment of

any new social security system would be impossible before 1997. China has not recognized the legitimacy of the current Legislative Council and has publicly announced to dissolve it immediately following return.

### ***Birth of Large-Scale Long-Term Funds and Trends in the Financial Sector***

The government plan was passed due to the approval from the business community, which formerly tended to oppose pension schemes. The new Provident Fund will mean new business opportunities for the financial community, the powerful member of Hong Kong business community along with the real estate developers, since mandatory contributions to the pension scheme will require management of large-scale long-term funds. The government estimates that if the compulsory pension fund scheme is implemented, HK\$30 to 40 billion, or the equivalent of 4 percent of the GDP, will be put into the fund every year.

The insurance sector and other financial institutions have welcomed the passage of the government bill. Due to the added burden on employers from premiums, as well as the paperwork involved in financial statements also required, however, small businesses, which have rarely participated in insurance programs in the past, have been concerned about rising personnel costs. The government has made certain promises in order to convince the Liberal Party, which is mostly comprised of businessmen, for its bill. These include pledges (1) not to raise premiums in the future, (2) to withdraw its bill if the possibility rises of the Legislature demanding and passing such an increase, and (3) to allow allowances for dismissals and long-term employment allowances to be used to offset premiums. Democratic Party criticizes these as undermining the function of the Legislature. Even before this, gridlock between the Legislative Council and the government resulted in a major delay in the establishment of the fund office. If this situation continues, the Mandatory Provident Fund scheme may very well not be launched until after 1997 return.

As seen from the description above, future rising social costs of welfare are evident in the recent changes in the welfare system. The era of "laissez-faire" welfare is quickly ending.

# Chapter VII

## Immigration, Emigration, Migrant Labor and Employment in Hong Kong

### Background

Hong Kong society and its population have always been in a hybrid state greatly affected by migration into and out of the territory. Historically, the 'visiting' and transient mentality of the 'dwellers' domicile in Hong Kong, as it was almost norm before the Second World War, was documented also officially in such dossiers as the Butters Report on Labor and Labor Conditions in Hong Kong. Mr. Butters, the then Labor Officer (equivalent to the Commissioner for Labor today), made reference to the 'Kiu Kong' fluidity of the Hong Kong residents because of their Chinese ethnicity and identity, as he reported in 1939 as below:

Certain local associations ..., instead of employing the words 'Hong Kong' in their names still use 'Kiu Kong' meaning that their members regard themselves as only temporarily resident in Hong Kong. Here they have no abiding home. And by Chinese law based on the *jus sanguinis*, persons of Chinese race, even if born in Hong Kong, are regarded as Chinese subjects. Such persons have therefore dual nationality.<sup>1</sup>

Neither has Hong Kong been immune, in its postwar drama of spectacular industrial and urban development, from the influences of migration from China which were both conducive as well as constraining to its growth. In retrospect, there was almost a consensual view shared among economists that the benchmarking experience of its industrial take-off in the fifties (it has become a classic as a model of 'late-development,' given the economic success Hong Kong has achieved as one of East Asia's leading newly industrialized economies, NIEs, today) was made possible basically because of the migration push emanating from the industrial-cum-urban centers of mainland China in the wake of sociopolitical upheavals that climaxed in the liberation and change of government to the PRC under the CCP leadership in 1949. It was a 'refugee' stampede combining the hybrid inflow of industrial

capital, entrepreneurship, industrial management and technological know-how, technical manpower and semi-skilled/unskilled labor in cheap and bulk supply. The spirit of 'migrant capitalism' and the half-insecure and half-neurotic laboring psychology of its predominantly 'refugee' workforce have hitherto given Hong Kong an efficacious local (business and work) ethos of 'industrialism' — pragmatic, responsive and sensitive, adaptive, flexible and yet instrumental, yearning for a high degree of marketplace and associated freedoms. Thus, it has been narrated by Chen:

The civil war ended with the establishment of a Communist regime in China in 1949. Under the pressure of these political events, a huge inflow of labor, capital, and entrepreneurial skill from China to Hong Kong occurred during the period 1948-51. Those taking refuge in Hong Kong included young and energetic people who were intelligent and willing to work hard, people with much money capital, and skilled entrepreneurs who were mostly Shanghainese industrialists engaged in the textile industry. This huge inflow of human and capital resources from China formed the basis of subsequent industrialization. At the same time, there was also an inflow of capital and entrepreneurial skill from the West and from South-East Asia, as Hong Kong was at that time the most stable place in Asia, both politically and economically.<sup>2</sup>

The mainland stampede of immigrants into Hong Kong subsided as cross-border control was instituted by both the Chinese and Hong Kong authorities later in the fifties. The demographic 'fluidity' of the territory was also steadily drained away as its society became increasingly detached from the mainland:

'Prior to 1941 Hong Kong had always attracted a high proportion of migrant male workers from the neighboring Guangdong province. ... Since 1950, however, the vast majority of the population ceased to be transients. Most people who work in Hong Kong are now also permanent residents in the colony.'<sup>3</sup>

Notwithstanding the institutionally enhanced 'divide' levied at the Sino-British border which has effectively stalled and pre-empted any large-scale demographic influx of mainland Chinese arrivals at Hong Kong, there have been sporadic spurts, during the last several decades, in their entries into the territory which more or less mirrored the shifting politico-economic mood inside China. The 'stampede' was, for example, 'resumed for only a brief period in 1962 when the Chinese authorities suddenly removed the restrictions' – leading to, at its peak, one six-week period in which 'over 600,000 illegal immigrants were arrested and returned to China, while a similar number probably evaded arrest.'<sup>4</sup> Otherwise, the Hong Kong society had been sustained almost in a virtual state of 'enclave' which depends primarily upon the natural growth of its population. In spite of its transient nature before the fifties and its refugee background, a 'native' home consciousness began to emerge and take root in the locally born postwar (or post-liberation) generations whose 'migrant' mentality also steadily subsided.

As Hong Kong industrializes and hastens its growth in the subsequent period after the sixties, while its demographic structure consolidates as its population matures with declining birth rate and natural growth, labor shortage starts to develop. Gradually uplifting itself, by virtue of the above development, from the low-income 'trap' of a surplus labor economy (and also socially improving its world image and becoming less castigated as a big subcontracting sweatshop in the realm of the international division of labor), Hong Kong's income and wage differentials vis-à-vis its hinterland across the border have widened to such a glaring gap that it would have served as a powerful force attracting mainland labor to migrate (across the border) in search of lucrative economic and job opportunities available in the territory – were it not for the tight 'iron grip' of bureaucratic controls owed to the 'household registration' system in the mainland and the 'cross-border' immigration checks and barriers which the Sino-British authorities enforced.

Such administrative and institutional controls did appear to ease and become considerably relaxed at the dawn of China's modernizations as it began to open the country to foreign trade, commerce and capital. The euphoria of the embryonic reform mood instigated and inspired a creeping inflow of unauthorized (or illegal) mainland immi-

grants into Hong Kong in the latter half of the seventies – not seeking political asylum but searching for gainful economic opportunities. These unlawful entries were for a brief interval being tolerated by the Hong Kong government, provided that such arrivals were able to make for and reach the urban areas – by a practice generally described as the 'touch base' policy. Such a liberal yet transient 'interlude' in Hong Kong's immigration history is documented, for instance, in such a narrative brief as below:

Coinciding with the inflow of Vietnamese refugees was the pressure of immigrant movements from China around the turn of the decade. The bulk of the Chinese immigrants arriving during this period were illegal entrants without proper official documentation – largely aspiring to the materialistic affluence of life-style in Hong Kong and encouraged by the relative tolerance of the 'touch-base' policy of the Hong Kong Government.

However, the magnitude of the stampede soon grew to such a level that the Hong Kong Government was forced to rescind its 'touch-base' policy, by which illegal Chinese immigrants who succeeded in evading arrest in the border and countryside and who secured urban accommodation would be allowed *de facto* right of stay.<sup>5</sup>

The 'touch-base' norm was hence merely a 'stop-gap' arrangement. After October 1990, illegal immigrants were no longer privileged by administrative clemency from apprehension upon arriving at the 'base.' Rather, they were equally liable to arrest and repatriation to China. In order to facilitate detection, the Immigration Ordinance was amended to require all adult residents in Hong Kong to carry their identity cards or equivalent documents, and to produce them for inspection upon demand by police, immigration or other authorized officers.

Anyway, the stampede during this temporary interval of liberal admission, as well as the subsequent intake, at a regular pace under an agreed quota jointly administered by the Chinese and Hong Kong authorities, of legal immigrants from the mainland has given rise to a significant yet peripheral segment of lesser skilled and lesser paid employment in the Hong Kong labor market. As a territory-wide labor study concludes in its review at the beginning of this decade, 'it appears likely that over 40 per cent of new entrants into the labor

market between our two surveys (1975 and 1985) came from this source.<sup>6</sup> Given the observation, based upon the findings in migrant-local pay differentials yielded by this study, 'that immigrant workers, or their counterparts in the imported labor force, are lower paid ... and liable to occupy jobs of lesser status and skills than the average member of the labor force,'<sup>7</sup> a secondary labor market appears to be consolidating slowly in Hong Kong where these socially disadvantaged workers are clustered. Their economic deprivations, insecurity and vulnerabilities suggest a local syndrome of 'urban poverty,' in spite of the relative industrial affluence and prosperity that Hong Kong society achieved in these recent years. Such a 'stratifying' phenomenon has hence been represented in these terms:

Openings of lesser jobs in the manufacturing industry provide, instead, tangible opportunities in the secondary labor market for marginal workers like recent immigrants, women workers or part-time employment, or home-workers in 'putting-out' arrangements.<sup>8</sup>

Although in Hong Kong, the buoyant labor market has continued to be 'sufficiently attractive to draw pockets of illegal immigrants from the mainland, especially for work at building and construction sites,'<sup>9</sup> the rescinding of the 'touch-base' policy since the early eighties has stemmed an important source of non-authorized migration and labor supply to the territory – which had served beforehand as an important 'safety-valve' for its manpower economy, now increasingly beset by 'labor scarcity' due to both sustained upsurge in industrial demand and withering natural growth of its population. Compounded by the territory's economic restructuring process touched off, *inter alia*, by the 'China' factor, labor and land scarcity coalesced, at the turn of the decade into the nineties, into a cost upward spiral of rapidly escalating inflation.

### Current Syndrome

The creeping syndrome of intensifying inflationary pressure which began to build up towards the turn of the decade touched off a vigorous lobby in the business sector demanding that the government, in spite of its initial reluctance and staggering attitude, liberalize and uplift its hitherto stringent policy of not admitting any general foreign guest workers including the semi-skilled and unskilled. Of

course, such non-admission of alien labor had indeed not been comprehensive and total, given that i) a liberal stance had always and consistently been maintained enabling expatriate managerial, administrative and professional personnel to enter the top echelon of the territory's manpower hierarchy on the grounds that they represent a beneficial factor of skill/know-how/capital transfer to Hong Kong (as justified by the claim that these expatriates, often overseas staff dispatched by multinationals, 'possess skills, knowledge, or experience of value to but not yet readily available in Hong Kong');<sup>10</sup> and ii) since 1973, foreign domestic helpers have been recruited and admitted in large numbers to work in households, now approaching a size of almost 150,000 and helping to relieve the housewives in many middle-income households for employment in the full-time labor market.

However, the government's concession to industry's demands led to the inception of a regulated intake, intended as a 'stop-gap' arrangement in coping with the economy's inflation and bottlenecks stemming from acute labor shortage, of general imported labor at the semi-skilled and unskilled levels – that eventually consolidated, at the beginning of the nineties, into two administratively distinct *ad hoc* schemes. The first, titled as the General Labor Importation Scheme, prescribes the hiring of alien guest workers, based upon a two-year standard contract which stipulates the payment of at least the median wage in the trade and industry concerned, according to an industrially differentiated quota determined and adjusted by the government with reference to criteria such as the industry's vacancy level, subject to a maximum, at the height of the intake, of not more than 25,000 for the entire scheme. The second, laying down regulatory conditions broadly analogous to the first, caters specifically to the new airport and associated infrastructural projects. As such, the admission quota is assigned basically to employers who are the building and construction contractors recruiting semi-skilled and unskilled labor from overseas – up to a ceiling not exceeding 17,000 in size.

As a sequel to the above enlargement of expatriate and alien guest labor in Hong Kong, the implications have been two-fold in affecting labor and employment in Hong Kong, which used to be conserved in a relatively 'enclave' situation at the lower-reach of its skill market, among the semi-skilled and unskilled manual workers.



The first has been the strong and persistent hostility articulated by the labor movement – apparently antagonized by the lack of adequate consultation with and the by-passing of organized labor's representatives in such advisory bodies as the Labor Advisory Board before the relevant public policy decision was made. Organized labor's vociferous disquiet has since been laden with an overtone of 'protectionism' – in appealing to the 'grassroots' sentiments in the currency of the 'electoral' games, as the political candidates sponsored by the labor unions are keen in bidding for the workers' votes (in, say, the September election for the Legislative Council last year). It canvasses assiduously a parochial perspective by patently blaming the newly imported guest workers for pre-empting the mid-career industrial workers dislocated and displaced from the quickly shrinking manufacturing sector (the drift of growing industrial unemployment is hitherto interpreted here as a syndrome of the territory's economic re-structuring process, as a drama of industrial joblessness due to the *en masse* immigration northwards of Hong Kong factories, pushed away by soaring and formidable hand and labor costs in search for cheaper and more ample supply across the border in the mainland) from transferring to job openings available in newer tertiary and service industries. The visiting alien worker is hence 'castigated' widely in the labor sector as the culprit responsible for perpetuating Hong Kong's creeping casualties of unemployment: in spite of the government's much publicized 're-training' efforts, the low transferability of the industrially unemployed to the service industries has rendered ineffective any correction to the existing inter-sectoral imbalances in the skill market stemming from labor surplus in the manufacturing sector and its scarcity in the newer industries. It has become an almost enshrined mission of the labor movement to 'crusade' for abolition of general labor importation as the key lever to the unemployment phenomenon that began to beset the territory in the mid-nineties.

The second ramification pertains to the vulnerabilities of the 'guest' workers, by virtue of their alienness and social marginalities, to workplace abuses and exploitation as 'sweat shop' labor. These problems have been attested to by recent disclosure in a number of labor grievance disputes affecting both mainland Chinese and Thai imported workers, hired in the airport and associated construction and

building sites, that these imported workers are susceptible to excessive wage deductions and other devious squeezes and malpractices levied by either the employer or the intermediary acting as the recruitment agency. In spite of the substantial assistance rendered by the local unions which actively intervened in helping these deprived visiting laborers to recover their legal entitlements in employment, ironically the same union organizations have also been the principal social agencies having instigated the public to 'arm' against labor importation. Their inhospitable or even hostile reception of the guest workers is a factor which explains the widespread and lingering social prejudices and discrimination cast against these workers as well as some of the restrictions insisted on by the government which effectively deny them any access to career advances like promotion.

However, it appears that the industrial drama spearheaded by organized labor's 'crusade' waged against imported workers from outside Hong Kong has by now largely subsided – since the government announced in September last year its decision to phase out the General Labor Importation Scheme with a substitutive but much diminished Supplementary Labor Scheme, whose scale was further trimmed down from a proposed size of 5,000 to 3,000 after haggling with the trade union movement. Paradoxically, the labor unions have been pretentiously silent about the existing, and rather sizable, population of expatriate professionals, corporate managers and executives as well as foreign domestic helpers. Their tacit toleration contrasts sharply with the high intolerance which these unions have determinately articulated towards the semi-skilled and unskilled 'alien' workers, especially those from the mainland.

### A Concluding Note

The present syndrome of importing migrant labor into Hong Kong is probably even more problematic than it appears. The past several years' experiment of attempting to enlarge the territory's labor supply pool by using the intake of manual labor imported *en masse* from outside Hong Kong has proved to be immensely unpopular locally and needs to be drastically curtailed, if not aborted. However, Hong Kong is still not entirely immune from the formidable socio-economic problem of





**"Sell a YAMAHA piano: Urgent due to immigration"**

having to balance its industrial growth, demographic development as well as employment and wage market adjustments. In a sense, as remarked on by some backseated economists with a skeptical note, Hong Kong as a relatively affluent and high income-earning city economy in Asia has to accommodate itself with the fact that its labor-scarce and opportunity-abundant economy will continue to attract migrant labor from other labor-surplus neighboring economies due to the conspicuous gaps of income differentials – now that international movement of people has been made more permissible and easier because of the widespread liberation of administrative controls on overseas travel and migration. Perhaps, a corrective promising better long-term stability is for the government to increase the regular intake of legal immigrants settling in Hong Kong from China – which it did, when it raised the daily quota from 75 to 150 on daily arrivals, jointly with Chinese authorities in 1995. However, steadily enhancing additions to the local population and labor supply are again perturbing in terms of duly increasing the propensity of this 'pluralistic' society to the risks of a future population and labor market 'glut.'

Compounding the issue even more is the 'brain drain' or emigration phenomenon in the wake of the imminent 1997 'changeover.' The exodus strained Hong Kong's manpower heavily in the earlier years of the nineties, especially in the upper echelon of executive and professional personnel. The drain has in turn made imperative the need for the territory to 'internationalize' its managerial-cum-professional markets – a logic of the market which

has combined with the advents implied by the 'human rights movement' about the industrial norm of non-discrimination of the 'expatriate minority' (especially notable in the civil service) to almost halt the earlier momentum of the 'localization' policies in the public sector and among the corporate employers. However, as the local 'fever' of a 'foreign passport' quest subsides, the emigration flood slowed down, coupled, ironically, with a reverse flow of the emigrants returning to Hong Kong in search for the relatively buoyant opportunities it offers. Again the prosperity and 'sustained' stability of this society, in spite of its current spectacular transition in anticipation of 1997, has proved to be the main pulling force – for both the 'returnees' as well as expatriates from abroad aimed at the white-collar professional and executive job market. Indeed, the latest official interpretation of the territory's creeping unemployment problem has been attributed partially as the cause of accelerated growth in the Hong Kong population and labor supply. In this context, the liberal admission of the expatriates – not to mention the spurred returning tide of emigrants – can be problematic in adding a new dimension to the current policy debate about unemployment and alien labor, now that a manpower glut from over-supply of university graduates (the number of universities in Hong Kong having mushroomed from three to six in the last two years, while a seventh and a eighth are in the pipeline) seems to possibly imply a small possibility that unemployment can also affect the upper strata of the local labor market for the professional and managerial white-collar workers. Also posing as a hiatus of likely uncertainty is the future policy decision of the Special Administrative Region (SAR) government about the status of a sizable population of foreign domestic helpers, mostly from the Philippines. The labor unions here have been remarkably quiescent about their stay in Hong Kong. However, a question of 'equity' has always remained unanswered: that is, why mainland China has consistently been denied as a source from which these domestic helpers can be recruited. The present practice of privileging intake drawn from the Philippines, Thailand, Indonesia and other East Asian societies to the exclusion of the mainland is hardly laudable and needs a comprehensive review of its rationalization.

Hong Kong society has always been permissible and pluralistic. And for that reason, it has also

been known for its 'openness' and 'fluidity.' A great deal of this historical character is due to the factor of migration, the effect of which is always felt in the labor and employment market. It will be an interesting challenge for the future SAR government to keep these diverse influences of the 'migration' phenomenon under rein in order to sustain a delicate equilibrium of the economy, the demography and the society beyond 1997.

#### Notes:

- 1 H.R. Butters, *Report by the Labor Officer on Labor and Labor Conditions in Hong Kong*, Sessional Paper No. 3, Hong Kong: Government Printer, 1939, para. 6, p. 108. Also see para. 47, p. 116.
- 2 Edward K. Y. Chen, "The Economic Setting," in Ng Sek-Hong and David G. Lethbridge (eds.), *The Business Environment in Hong Kong*, Hong Kong: Oxford University Press, 3rd Edition, 1995, p. 2.
- 3 David Lethbridge and Ng Sek-Hong, "The Business Environment and Employment," in David Lethbridge (ed.), *The Business Environment in Hong Kong*, Hong Kong: Oxford University Press, 2nd edition with a Postscript in Hong Kong in the 1990s, 1993, p. 80.
- 4 *Ibid.*, p. 80.
- 5 Ng Sek Hong, *Hong Kong*, a monograph in the series, R. Blanpain (ed.), *International Encyclopedia for Labor Law and Industrial Relations*, The Netherlands: Kluwer, 1990, Supplement 109, para. 262, p. 165.
- 6 H.A. Turner, Patricia Fosh and Ng Sek Hong, *Between Two Societies: Hong Kong Labor in Transition*, Hong Kong: Center of Asian Studies, University of Hong Kong, p. 38.
- 7 David G. Lethbridge and Ng Sek Hong, "Labor and Employment" in Ng Sek Hong and David G. Lethbridge (eds.), *The Business Environment in Hong Kong*, Hong Kong: Oxford University Press, 3rd edition, 1995, pp. 69-71.
- 8 *Ibid.*, p. 68.
- 9 *Ibid.*, p. 67.
- 10 *Ibid.*, p. 65.

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